

Arbitration of Statutory Rights Under the Federal Arbitration Act: The Case for Reform

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I. THE CAPACITY PROBLEM

A. Objectives of this Article

This Article has two basic objectives. The first is to trace the treatment by the Supreme Court of agreements to arbitrate statutory rights in contract disputes governed by the Federal Arbitration Act (FAA). By "statutory rights" I mean rights created by state or federal regulatory legislation to protect the interests of one party to the transaction and others similarly situated. This part of the Article is mainly descriptive. The second purpose is to evaluate how the Supreme Court has responded to claims that arbitration is ineffective or inappropriate to deal with statutory rights. These claims attack the capacity of arbitration to resolve disputes over rights that are imposed on rather than created by the contract in which the arbitration clause is contained.

My conclusions are that: (1) where the statutory rights are created by Congress, the Court's unitary, pro-arbitration enforcement of a federal contract to arbitrate leaves no room for doubt in an area replete with uncertainty about the capacity of arbitration to achieve its primary objectives in the regulated transaction; (2) where the statutory rights are created by state legislatures, the Court's conclusion that the FAA displaces state law which selectively limits the arbitration of statutory rights is an unwarranted impairment of the police powers; (3) the current standards for the judicial review of arbitration awards which decide statutory rights created by either Congress or the states provide an inadequate corrective when capacity defects actually materialize in the arbitral process; and (4) selected reforms are required. At a minimum, the courts should have clear authority, when statutory claims are involved, to vacate or modify an arbitrator's award where arbitral procedures denied an adequate hearing or where the arbitrator made a

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error of law. At the maximum, the displacement effect of the FAA on state regulation of arbitration where statutory rights are involved should be sharply limited.¹

These reforms, among others, are necessary to neutralize a developing case "against arbitration" and to encourage the development of different forms of arbitration to fit the complexity and importance of the particular dispute. In short, there are too many problems for the unitary and preemptive concept of arbitration developed by the Supreme Court under the FAA.

B. *Arbitration: The Classic Model*

Let us start with the basics. Arbitration is a form of Alternative Dispute Resolution (ADR). Unlike other methods of ADR, however, arbitration is a private adjudicatory process invoked as an alternative to filing a law suit. The classic model of arbitration can be reduced to three essential elements. First, arbitration depends upon consent. The parties must agree, either before or after the dispute arises, to arbitrate the dispute. In most cases, that agreement will be evidenced by mutual assent to a commercial or consumer contract which contains a written arbitration term.

Second, arbitration is a less formal adjudicatory process that has assumed advantages over litigation in courts or other forms of ADR.² The parties expect that an unbiased and competent private arbitrator will conduct a relatively expeditious, informal, inexpensive, and private hearing and decide the merits of the dispute fairly between them.³

Third, the arbitrator is empowered by the agreement and applicable arbitration rules to make a final decision on the merits of the dispute,

1. One such limitation is where the parties have agreed to arbitrate under the law of a state imposing conditions on the contract right to arbitrate not found under federal law. In *Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University*, 109 S.Ct. 1248 (1989), the Supreme Court held, in a 6-2 decision, that such a choice of law provision was enforceable even though the agreement was otherwise governed by the Federal Arbitration Act.

2. See generally Bush, *Dispute Resolution Alternatives and the Goals of Civil Justice: Jurisdictional Principles for Process Choice*, 1984 WIS. L. REV. 893.

3. An empirical question, for which there is no clear answer, is whether arbitration is effective in achieving justice between the parties at an advantage in time and expense over litigation. The relevant studies are analyzed in Stipanowich, *Rethinking American Arbitration*, 63 IND. L.J. 425 (1988). The dominant themes, as developed from interviews with the users of arbitration (mostly attorneys), were summarized as follows: "On the positive side, these include the relative speed and efficiency of arbitration, particularly in smaller cases, and arbitrator expertise. Prominent concerns include attorney-caused delays, inadequate arbitrator selection methods and consequent variations in arbitrator quality, the absence of written opinions accompanying arbitral awards, and high administrative costs." *Id.* at 472. Professor Stipanowich concludes that "efforts to determine how effectively arbitration works and what improvements might be made to the system have been hampered by the relative lack of meaningful empirical data." *Id.* at 432.

i.e., to decide both questions of fact and of law and to provide appropriate remedies.⁴

Unlike the judicial process, there is no review of the merits of this primary decision by the arbitrator. In the absence of fraud, bias, or process defects, the court is empowered to confirm and enforce the award as if it were a final judgment. There are, of course, incentives for negotiated settlement within the arbitral process and the arbitrator's decision will frequently contain an element of compromise. Nevertheless, in whatever contexts arbitration is invoked, the parties participate in the decisional process by presenting evidence and reasoned arguments to an arbitrator whose final decision should be responsive to the dispute as presented.⁵ As a practical matter, finality is achieved when both parties acquiesce in the arbitrator's decision with or without seeking limited judicial review.⁶

C. Characteristics of Arbitration

Although an objective of arbitration is to achieve justice between the parties through less formal adjudication, the quality of justice may be different (if not less) than that achieved in civil litigation. As one court warned, arbitration is "not the most perfect alternative to adjudication" in the courts. It is "an inferior system of justice, structured without due process, rules of evidence, accountability of judgment or rules of law." In short, "parties should be aware that they get what

4. Compare Note, *Private Judging: An Effective and Efficient Alternative to the Traditional Court System*, 21 VAL. U.L. REV. 681 (1987) (private judging as a statutory process whereby parties refer a dispute to a neutral third party whose decision has the effect of a traditional court judgment).

5. See Fuller, *The Forms and Limitations of Adjudication*, 92 HARV. L. REV. 353, 363-64 (1979). Like other forms of ADR, arbitration can elevate the prominence of the parties and deemphasize the role of the attorney in the hearing. See Brunet, *Questioning the Quality of Alternate Dispute Resolution*, 62 TUL. L. REV. 1, 12 (1987).

6. Arbitration law and institutional practice will influence the behavior of the parties. If, for example, trade practice favors arbitration, participants may be more willing to arbitrate and less inclined to seek relief from the arbitration agreement or the award in court. Similarly, if arbitration law favors the arbitration agreement and finality of the award, a disappointed party will have less incentive to sue. See Bonn, *The Predictability of Non-Legalistic Adjudication in the Textile Industry*, 27 ARB. J. 29 (1972). It is an open question how much influence these factors have on decisions to arbitrate or to seek relief in court and whether the pressure actually exerted is healthy. Compare Kronstein, *Arbitration is Power*, 38 N.Y.U. L. REV. 661 (1963), who railed against the potential for abuse by private arbitration panels serving private interest without judicial review. One can predict that if one party gets some but not all of the claim in arbitration, that gain can be balanced against the estimated cost and probable success of a judicial appeal. See Bush, *supra* note 2. Unless agreed settlements of specified claims are against public policy, an informed calculus made in favor of acquiescence should be no cause for concern. For a brief discussion of adjudication outside of courts, see Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (And Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4, 34-36 (1984).

they bargain for and that arbitration is far different from adjudication.”⁷

What do the parties get when they bargain for arbitration? The characteristics of the classic model of arbitration, along with its potential strengths and limitations, emerge when it is contrasted with the judicial process.⁸ For emphasis, the differences will be stated in the extreme.

1. *Control Over Scope, Content and Arbitrator Selection.* As a voluntary⁹ dispute resolution technique, one party can avoid arbitration by refusing to agree to arbitrate an existing or future dispute. But if a decision to arbitrate is made, the parties have an opportunity to define the scope and content of the process as well as to control its procedures in the agreement. The same cannot be said for civil litigation. Similarly, the arbitrator is selected by or through procedures agreed to by the parties while the judge is imposed upon them by law and local allocation practices.¹⁰

2. *Less Formality and Complexity.* Arbitration procedures and fact finding processes are not clearly defined or required by arbitration statutes. They depend upon the agreement, relevant arbitration practice or institutional procedures, such as the American Arbitration Association (AAA) Arbitration Rules, and are usually less formal than those in court. The arbitrator has less authority than a judge to order discovery or to compel the attendance of witnesses or the production of evidence. The parties have less power to engage in pretrial discovery. The parties, however, may define by agreement the procedures and the powers of and even the substantive law and remedies to be applied by the arbitrator. In the absence of such agreement, arbitration procedures may be attended with a great deal of uncertainty.¹¹

3. *Duration of Proceedings.* In arbitration, the arbitrator and the parties control the timing, duration, and complexity of the hearings. In judicial proceedings, these matters may be beyond the parties' control. The potential for savings in time and cost, therefore, differs. In short, arbitration is expected (and assumed) to be quicker, less formal and less expensive than litigation in court.

7. *Stroh Container Co. v. Delhi Indus.*, 783 F.2d 743, 751, n.12 (8th Cir.), *cert. denied*, 476 U.S. 1141 (1986).

8. For a useful, comparative chart, see Green, *A Comprehensive Approach to the Theory and Practice of Dispute Resolution*, 34 J. LEGAL ED. 245, 257-58 (1984).

9. So-called mandatory arbitration, such as court-annexed arbitration, is not truly arbitration at all. After a lawsuit is filed, the parties are compelled to submit the disputes to an arbitrator whose decision is not final. *See, e.g.*, Walker, *Court-Ordered Arbitration Comes to North Carolina and the Nation*, 21 WAKE FOREST L. REV. 901 (1986); Note, *On Behalf of Mandatory Arbitration*, 57 S. CAL. L. REV. 1039 (1984).

10. *See* Federal Arbitration Act, 9 U.S.C. § 5 (1982), where the court is authorized to designate an arbitrator if the parties have failed to provide a method of selection or the provided method fails.

11. *See* Stipanowich, *supra* note 3, at 443-45; Shell, *Res Judicata and Collateral Estoppel Effects of Commercial Arbitration*, 35 UCLA L. REV. 623, 629-35 (1988).

4. *Arbitrator Expertise.* In arbitration, the arbitrator is expected to be an expert in or familiar with the context within which the dispute arose while a judge will, normally, have no special expertise.¹² Furthermore, an arbitrator is not required to produce a written opinion with reasons for the decision. Presumably, this reduces the risk of disagreement over reasons by parties otherwise satisfied with the result. In court, a reasoned opinion by a judge is required.

5. *Confidentiality.* Arbitration is touted as a private process where confidence is normally maintained while the opposite is true in court.

6. *Justice Between the Parties.* A primary objective in arbitration is to achieve a just result between the parties.¹³ But arbitration seeks particularized justice rather than to foster substantive consistency and predictable results for the future. Courts, on the other hand, are concerned both about just results and announced precedent and the effect of the decision on third persons who are not parties to the litigation.

Furthermore, in arbitration, a compromise decision is possible while judicial decisions tend to be either win all or lose all. According to some observers: "The arbitration process frequently resembles three-party negotiation or mediation, with many arbitrators consciously or unconsciously identifying outside parameters of possible settlement and endeavoring to reach a decision that will at least be minimally acceptable to both parties."¹⁴

In sum, arbitration is a form of consensual, relatively informal, personalized adjudication where the primary objective is to obtain less expensive justice between the parties.¹⁵ The challenge is to obtain particularized justice in an extra-legal adjudicatory process which has potential strengths and weakness when compared to civil litigation.¹⁶

12. Concerns regarding arbitrator selection and competence are discussed by Stipanowich, *supra* note 3, at 447-53.

13. Unlike other forms of ADR, with their emphasis upon settlement, an objective of arbitration, with all of its limitations, is "not simply to resolve a dispute but to resolve it justly." Fiss, *Second-Class Justice*, Conn. L. Tribune, Mar. 17, 1986, at 1, 10.

14. E. JOHNSON, V. KANTOR & E. SCHWARTZ, *OUTSIDE THE COURTS; A SURVEY OF DIVERSION ALTERNATIVES IN CIVIL CASES* 55 (1977). See Shell, *supra* note 11, at 633-35. But see F. KELLOR, *AMERICAN ARBITRATION* 5, 26, 85 (1948), who insisted that a final, just decision is impaired if the arbitrator either participates in settlement negotiations between the parties or makes a compromise decision.

15. See *Keating v. Superior Court*, 31 Cal. 3d 584, 595, 645 P.2d 1192, 1198, 183 Cal. Rptr. 360, 366 (Cal. 1982), *rev'd on other grounds*, 465 U.S. 1 (1983), where the court said: "Arbitration is generally considered to be a mutually advantageous process, providing for resolution of disputes in a presumptively less costly, more expeditious, and more private manner by an impartial person or persons typically selected by the parties themselves."

16. Professor Brunet identifies six functions common to ADR that can be found in some degree in arbitration: (1) speedy and low cost dispute processing; (2) de-emphasis of judicial involvement; (3) emphasis on party or client direction and de-emphasis on attorney representation; (4) minimal and informal adjudicative procedures; (5) private proceedings; and, (6) creative norm production and avoidance of substantive law. Brunet, *supra* note 5, at 10-15.

These are the basics. How well does the classic model of arbitration with its differences from litigation achieve its objectives in the regulated transaction?¹⁷

D. *Arbitral Capacity in the Regulated Transaction*

1. *Arbitration and the "Case Against Settlement."* There are recurring doubts about the *capacity* of arbitration to achieve satisfactory results in all cases, even though the parties have agreed to arbitrate the dispute.¹⁸ These are selective concerns. They focus upon the limitations of arbitration as an effective adjudicatory process in complex cases¹⁹ or upon the inappropriateness of private adjudication to resolve issues of public importance.²⁰ These questions of *effectiveness* and *appropriateness* have been frequently raised where the parties have contested rights created by regulatory legislation and have agreed to arbitrate disputes that

17. Professor Shell, in analyzing the effect of *res judicata* and collateral estoppel in commercial arbitration, has concluded that apart from similarities in form, "the analogy between arbitration and court adjudication breaks down . . ." Apart from the fact that arbitration is a private rather than a public institution with "categorically different" factfinding models, "arbitration awards are frequently unexplained and difficult to interpret." As a result, "[t]his deliberate lack of reasoned explanation for arbitrator's decisions raises serious questions of accountability." Shell, *supra* note 11, at 658-60.

18. The probability that arbitration will achieve its basic objectives is reduced when the following facts are present:

(1) At the time of contracting, one party had relatively little understanding of the nature and objectives of arbitration or both parties, because of inadequate planning, failed to foresee the nature and complexity of the dispute which actually arose. This would increase the degree of post-dispute regret over the earlier decision to arbitrate.

(2) The dispute arose from a relationship between the parties which has ruptured, thus reducing the incentive to accept the award and preserve the relationship.

(3) The nature and complexity of the dispute tests the competence of the arbitrator to achieve justice between the parties or the capacity of the available procedures to build an adequate record and to accomplish the intended objectives of speed, informality and lower costs.

(4) The dispute arose in a context where institutional arbitration devices, if any, are ineffective or apparently biased in favor of one party or hostile, in general, toward arbitration.

(5) Important external or "public" interests are involved which suggest that the dispute should be adjudicated by a court. These might include statutory rights created for the protection of one party or a class of persons similarly situated or the "public" interest in the enforcement of the antitrust laws. See Shell, *supra* note 11, at 628-35, 657-63. See also Getman, *Labor Arbitration and Dispute Resolution*, 88 YALE L.J. 916 (1984); Furnish, *Arbitration and Long-Term Commercial Agreements*, 26 AM. J. COMP. L. 123 (Supp. 1978); Carlston, *Theory of the Arbitration Process*, 17 LAW & CONTEMP. PROBS. 631 (1952).

19. E.g., Stipanowich, *supra* note 3.

20. It is claimed that arbitration is ill-suited to resolve disputes over legal rules that are "designed to protect the interests of third parties or the public at large, and thus foster ends other than fairly resolving the dispute between the parties." Sterk, *Enforceability of Agreements to Arbitrate: An Examination of the Public Policy Defense*, 2 CARDOZO L. REV. 481, 492-93 (1981). See also Kanowitz, *Alternative Dispute Resolution and the Public Interest: The Arbitration Experience*, 38 HASTINGS L.J. 239 (1987).

"relate to" as well as rights "arising out of" the underlying contract in which the arbitration clause is contained.²¹

Doubts about arbitral capacity parallel doubts about a primary objective of the ADR movement, namely agreed settlement. ADR seeks to increase the incidence of negotiated settlement and decrease the need for decisions on the merits by a court. The objectives and methods of ADR operate whether or not a lawsuit has been filed, although considerable attention has been lavished on post-suit ADR.²²

However the process is orchestrated, the primary objective in ADR is to achieve peace²³ through an agreed settlement of the dispute. The difficult question is when the achievement of peace through agreement is at an unacceptable cost to the demands of justice through civil litigation.²⁴

Some critics are not pleased about the quality of justice dispensed through ADR. In a far ranging article,²⁵ Professor Edward Brunet has argued that the procedures of ADR fail to achieve consistent "outcome

21. See Morgan, *Contract Theory and the Sources of Rights: An Approach to the Arbitrability Question*, 60 S. CAL. L. REV. 1059 (1987). Morgan draws a Kantian distinction between the arbitration of rights created by the underlying contract and those created by the collective processes of the state.

22. See generally Sander, *Alternative Methods of Dispute Resolution: An Overview*, 37 U. FLA. L. REV. 1 (1985).

23. See H. HAVIGHURST, *THE NATURE OF PRIVATE CONTRACT* 21 (1961), who suggests that "peace," whether resolving an existing controversy or promoting harmony in the future, is one of four "uses of contract-in-fact."

24. In a well known article, Fiss, *Against Settlement*, 93 YALE L.J. 1073 (1984), Professor Owen Fiss argued that "settlement is a capitulation to the conditions of mass society and should be neither encouraged nor praised" and identified four factors that contributed to a case "against settlement": first, power imbalances between the parties affect the bargaining process and contribute to an unfair distribution of resources; second, in complex relationships, it will be difficult to determine who has authority to bind others by consent; third, after the agreed settlement, there is no continuing judicial involvement to insure that the agreement is performed; and fourth, peace is achieved at some cost to justice, in that a primary task of civil adjudication is to "explicate and give force to the values embodied in authoritative texts, such as the constitutions and statutes (and) to interpret those values and to bring reality into accord with them." *Id.* at 1085.

Professor Fiss's "case," which views litigation through a public law lens, has not been received with enthusiasm in the camps of ADR. See, e.g., Kaufman, *Must Every Appeal Run the Gamut?—The Civil Appeals Management Plan*, 95 YALE L.J. 755, 764 (1986), who concludes: "I have long suspected the best justice is done when the parties voluntarily abandon litigation in favor of a solution that does not leave one party scarred and the other exalted." See also *Symposium on Litigation Management*, 53 U. CHI. L. REV. 305 (1987); Menkel-Meadow, *For and Against Settlement: Uses and Abuses of the Mandatory Settlement Conference*, 33 UCLA L. REV. 485 (1985). His case "against" settlement is undifferentiated and seemingly slights the apparent advantages of negotiated settlement of many disputes, either before or after litigation is commenced. See generally Bush, *supra* note 2. Compare Chayes, *The Role of the Judge in Public Law Litigation*, 89 HARV. L. REV. 1281 (1976).

25. Brunet, *Questioning the Quality of Alternative Dispute Resolution*, 62 TUL. L. REV. 1 (1987). The article contains, among other things, a comprehensive citation and discussion of the relevant ADR literature, including a limited discussion of arbitration.

accuracy" and that the outcomes of ADR do not give proper deference to "substantive legal norms."²⁶ Rather, ADR is an "almost entirely procedural concept" designed to "terminate disputes informally and silently."²⁷ According to Brunet, ADR, to achieve quality justice, must have procedures that "do not ignore substantive law and that facilitate the crucial guidance function of positive law."²⁸

These concerns about adequate fact finding procedures, the de-emphasis of substantive law, and the absence of judicial involvement in the merits in ADR parallel questions about the effectiveness and the appropriateness of arbitration to decide statutory rights. They recall, in general, Professor Kronstein's warning, given some forty-five years ago, about the potential abuse of private power exercised through commercial arbitration as an "institution of private government."²⁹ More particularly, they question the capacity of arbitration, an adjudicatory method of dispute settlement, to consistently achieve just results between the parties and to protect the interests of third parties, in disputes over statutory rights.

2. *A Regulatory Example.* To illustrate, consider the following hypothetical example. Suppose that a state legislature or Congress, after a careful study, enacted legislation to regulate the contractual relationship between franchisers and franchisees. In addition to limiting the power of the franchiser to terminate the franchise, the statute provided an expansive definition of fraud by the franchiser and created a private right of action with special remedies for the franchisee. The franchisee could recover compensatory damages and, in appropriate cases, punitive damages and attorney's fees. The legislation also stated that agreements by the parties purporting to "contract out" of the duties imposed and rights created by the statute were "void."

Under the model so far, franchisees alone or as a class are empowered to enforce the statutory rights in court to protect their own interest and to act as a private attorney general. It is conceivable that the legislation might also proscribe certain conduct by the franchiser as a crime or establish an administrative agency with power to enjoin or to exact civil penalties for violations. Let us suppose, however, that the legislature left the enforcement of the legislation to the private parties for whom the statutory rights were created, the franchisees.

A second set of regulatory options involves arbitration. In an extreme form, the legislature could clearly prohibit the arbitration of rights

26. *Id.* at 8-9.

27. *Id.* at 14.

28. *Id.* at 55.

29. Kronstein, *Business Arbitration—An Instrument of Private Government*, 54 *YALE L.J.* 36 (1944). This theme was reiterated and embellished in a subsequent article. Kronstein, *supra* note 6.

created by the statute. All statutory rights must be adjudicated in court because arbitration is deemed to be inappropriate.³⁰ Or, the legislature or Congress could enact a special set of arbitration procedures for the conduct of arbitration hearings or standards for the judicial review of awards. For example, the arbitrator might be empowered to hold a more formal hearing on the legal issues involved and be required, in making a final award, to state findings of all relevant material facts and make applicable determinations of law. Similarly, the court might be given broader power to review the merits of the award.³¹ Finally, the legislature could require the franchiser to provide more information and choice about arbitration. Thus, a franchiser might be required to clearly inform the prospective franchisee that an arbitration clause was included in the franchise agreement and give the franchisee a choice to "take it or not" without losing the opportunity to contract. If made, this statutory regulation of arbitration would be a direct response to doubts about arbitral capacity in the adjudication of franchise disputes.

Suppose, as is likely, that the regulatory legislation says nothing about arbitration. Assume further that there is no specialized, stable context within which the arbitration of franchise disputes regularly occurs. There is no franchise trade association to develop sound arbitration procedures, furnish reliable administrative support and be the "keeper" of arbitration practice. In this setting, the parties, therefore, must depend upon the American Arbitration Association (AAA) for rules of procedures and administrative support rather than a franchising trade association.³² Undoubtedly, they will agree to some variation of the "broad" form arbitration clause recommended by the AAA, under which they are obligated to arbitrate "all disputes arising under or related to the contract, or the breach thereof."

3. *Questions for Consideration.* This, then, is a hypothetical example of a regulated transaction, franchising, where arbitration is a common method of dispute resolution.³³ Other possible contexts for regulation

30. As an English scholar put it: "(I)t is in the highest interest of the State, that it is a matter of public policy of great import to maintain the principle of judicial review of arbitration, not only to develop the law, but also to ensure the administration of justice and thus avoid the risk of arbitrariness." Mann, *Private Arbitration and Public Policy*, 4 CIV. JUST. Q. 257, 267 (1985).

31. See, e.g., New Jersey Alternative Procedure for Dispute Resolution, N.J. STAT. ANN. § 2A:23A (West 1987); Comment, *The New Jersey Alternative Procedure for Dispute Resolution Act: Vanguard of a "Better Way"?*, 136 U. PA. L. REV. 1723 (1988).

32. See Mentschikoff, *Commercial Arbitration*, 61 COLUM. L. REV. 846, 849 (1961). Mentschikoff distinguishes arbitrations administered by the AAA from those arising within a particular trade association or exchange. Compare Getman, *Labor Arbitration and Dispute Resolution*, 88 YALE L.J. 916 (1979), who identifies the factors contributing to the effectiveness of arbitration under collective bargaining agreements.

33. See generally Daughtrey, *Enforcement of Arbitration Clauses Against Deceived Franchisees*, 21 U. RICH. L. REV. 391 (1987); Rudnick, *Arbitration Clauses in Franchise Agreements*, 28 BUS. LAW. 613 (1973). See also Brown, *Current Panorama of Private Litigation Rights in Franchising*, 18 NEW ENG. L. REV. 273 (1982).

include insurance contracts, contracts for the sale of automobiles and other settings, such as the securities industry, where individuals contract with organizations and statutory rights are involved. In the absence of explicit legislative regulation of arbitration, the following questions about the capacity of arbitration in such settings are frequently raised.

First, if the arbitration clause was drafted by the franchiser and offered to the franchisee on a "take it or leave it" basis, should the franchisee be compelled to arbitrate? To what extent is the standard form agreement an unconscionable "contract adhesion"?³⁴

Second, should a "broad" arbitration clause be interpreted without more to include the arbitration of statutory rights—rights that are created by statute for the protection of the franchisee and the public rather than arising from the underlying contract of the parties?³⁵

Third, are normal arbitration procedures capable of responding to the challenge of providing a fair hearing to the parties in complex cases where statutory rights are involved?³⁶

Fourth, do arbitrators have the competence to interpret and apply the law and to make awards which adequately protect the statutory rights of the protected parties?³⁷

Fifth, can an arbitration award (a) protect the interests of third parties, *i.e.*, a class of franchisees similarly situated, who are affected by the franchiser's conduct but are not parties to the arbitration agreement and cannot be compelled to participate and (b) can arbitration awards vindicate and adequately enforce the public interests which are at stake in the private adjudication of statutory rights, particularly where the arbitrator is not required to prepare or to publicize an opinion

34. The judicial answer is rarely, if ever. Assuming that one party is not unfairly surprised by the inclusion of an arbitration clause, the choice to "take it or leave" it is tempered by the fact that the other party is also bound to arbitrate the dispute. Unless the contemplated arbitration procedures are inadequate or the arbitrator is biased—conditions difficult to establish in advance of arbitration—the courts have been unwilling to decide that the party seeking to avoid arbitration was a victim of "oppression." *See, e.g., Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 623 P.2d 165, 171 Cal. Rptr. 604 (1981). *See also Pierson v. Dean, Witter, Reynolds, Inc.*, 742 F.2d 334, 339 (7th Cir. 1984) (party seeking to avoid agreement to arbitrate submitted no evidence that clause was commercially unreasonable or that he lacked a reasonable opportunity to understand it); Di Fiore, *Problems in Alternate Dispute Resolution: Arbitration Agreements as Contracts of Adhesion in Consumer Securities Disputes*, 93 COM. L.J. 259 (1988). *See also infra* text accompanying notes 72-84.

35. The answer of the Supreme Court is an emphatic yes. *See infra* text accompanying note 142.

36. Regardless of the truth, the answer is assumed by the Supreme Court to be yes when the enforceability of the agreement to arbitrate is at issue. *See infra* text accompanying notes 126-57.

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which, in any event, would have no precedential effect?³⁸ We will devote the balance of this Article to providing answers to these questions.

II. ARBITRATION LAW UNDER THE FAA: SCOPE AND EFFECT

A. *The Role of Arbitration Law*

As a matter of arbitration practice, the empirical question is whether arbitration has the capacity, measured in terms of effectiveness and appropriateness, to resolve claims involving statutory rights. Although there are no satisfactory answers to this question, doubts persist.³⁹ As a matter of arbitration law, however, the questions are limited to whether a court should enforce the alleged agreement to arbitrate or, if an award has been made, confirm the award and enter a judgment. A critical inquiry is the degree to which doubts about the capacity of arbitration to decide statutory rights are relevant to the legal questions posed.

Arbitration law is typically invoked by one of the parties at two points: (1) at the threshold, where the question is whether the alleged agreement to arbitrate should be enforced; or (2) after the arbitration, where the question is whether the final award made by the arbitrator should be confirmed and enforced by the entry of a judgment or otherwise be given preclusive effect. Under modern arbitration legislation, at neither point is the court permitted to examine the merits of the dispute. Rather, the questions are whether the dispute was "arbitrable" or whether the arbitrator's final award should be vacated or modified on the basis of limited statutory grounds.⁴⁰ In general, doubts about arbitral capacity must be raised at these two points.⁴¹

Initially, the question which arbitration law is applicable may be raised. The choices include state arbitration statutes, such as the Uniform

38. Regardless of the truth, the answer to these questions of public policy is assumed by the Supreme Court to be yes when the enforceability of the agreement to arbitrate is at issue, unless Congress has clearly spoken to the contrary. A clear answer by the states, however, is irrelevant in cases to which the FAA applies. *See infra* text accompanying note 60-84.

39. *See, e.g.,* Stipanowich, *supra* note 3.

40. *See* Note, *The Scope of Modern Arbitral Awards*, 62 TUL. L. REV. 1113 (1988).

41. The federal courts have been reluctant to hear appeals from the decisions of arbitrators made after appointment but before final award. *See* *Florasynth, Inc. v. Pickholz*, 750 F.2d 171, 174 (2d Cir. 1984) (no authority to review propriety of arbitrator's resignation before award). *But see* *Aerojet-General Corp. v. American Arb. Ass'n*, 478 F.2d 248, 251 (9th Cir. 1979), where the court reviewed a procedural decision of the arbitrator to "prevent manifest injustice." Some state courts have held that they have inherent power, upon request, to disqualify an arbitrator for evident partiality before an award is made. *See, e.g.,* *Astoria Medical Group v. Health Ins. Plan of Greater N.Y.*, 11 N.Y.2d 128, 182 N.E.2d 85 (1962).

Arbitration Act,⁴² the Federal Arbitration Act (FAA), the Labor Management Relations Act⁴³ or various arbitration schemes developed to resolve disputes arising within federal administrative programs.⁴⁴ Assuming that the proper legislation is applied, the legal questions presented remain constant even though the nature of the underlying dispute or the relevant context may vary.

B. Scope of the Federal Arbitration Act

Congress enacted the FAA in 1925.⁴⁵ A primary purpose was to insure the enforceability of agreements to arbitrate future disputes⁴⁶

42. Uniform Arbitration Act, 7 U.L.A. 1 (1985 & Supp. 1987). For a current listing of state arbitration statutes, see M. DOMKE, DOMKE ON COMMERCIAL ARBITRATION, App. 1 (Rev. Ed. 1984).

43. Section 203(d) of the Labor Management Relations Act, 29 U.S.C. § 173(d) (1976), provides that "final adjustment by a method agreed upon by the parties is declared to be the desirable method for settlement of grievance disputes arising over the application or interpretation of an existing collective bargaining agreement." Under the LMRA, labor arbitration law has been developed by the courts as a matter of federal common law. Although sometimes used by analogy, Congress probably intended to exclude collective bargaining agreements from the scope of the FAA. See Ray, *Court Review of Labor Arbitration Awards Under the Federal Arbitration Act*, 32 VILL. L. REV. 57 (1987).

44. A notable example is the arbitration of disputes between private parties over the use of proprietary data under the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA), 61 Stat. 125, as amended, 7 U.S.C. § 136 (1982). If the parties are unable to resolve the dispute by agreement, FIFRA requires final arbitration under specially developed rules and procedures. See 7 U.S.C. § 136a(c)(1)(D)(ii) (1982) and 29 C.F.R. Ch. XII, Part 1440. The Supreme Court has held that the FIFRA arbitration system was within the power of Congress under Article I of the Constitution and was not an improper intrusion on the judicial power of the United States under Article III. *Thomas v. Union Carbide Agric. Products Co.*, 473 U.S. 568 (1985); see also Note, *FIFRA Data-Cost Arbitration and the Judicial Power: Thomas v. Union Carbide Agricultural Products Co.*, 13 ECOLOGY L.Q. 609 (1986). See generally Administrative Conference of the United States, Sourcebook: Federal Agency Use of Alternative Means of Dispute Resolution (1987).

45. The FAA, originally called the United States Arbitration Act, was enacted on February 12, 1925. Federal Arbitration Act, ch. 213, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1-14 (1982)). Important sources of legislative history are H.R. Rep. No. 96, 68th Cong., 1st Sess. (1924) and S. Rep. 536, 68th Cong., 1st Sess. (1924). See also Note, *The United States Arbitration Act and Its Application*, 11 A.B.A. J. 153 (1925) (tracing bill from origination in the ABA's Committee on Commerce, Trade and Commercial Law to enactment); Cohen & Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265 (1926).

The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) was ratified by the United States in 1970, 21 U.S.T. 2517, T.I.A.S. No. 6997 (1970), and is codified in 9 U.S.C. §§ 201-208 (1982).

46. In effect, the FAA rejected the common law hostility to the enforcement of agreements to arbitrate future disputes, reflected in the "ouster of jurisdiction" doctrine. Federal Arbitration Act, 9 U.S.C. § 2 (1982). As Judge Hough put it in 1915: "The courts will scarcely permit any other body of men to even partially perform judicial work, and will never permit the absorption of all business growing out of disputes over a contract by any body of arbitrators, unless compelled to such action by statute." *United States Asphalt Refining Co. v. Trinidad Lake Petroleum Co.*, 222 F. 1006, 1010-11 (S.D.N.Y.

and, thus, to put contracts to arbitrate on the same footing as other contracts.⁴⁷ This was done in FAA section 2 by providing that a "written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."⁴⁸ To implement this federal contract right to arbitrate, the federal courts were granted power to compel arbitration when the dispute was arbitrable⁴⁹ and to stay litigation previously commenced until the arbitration was concluded.⁵⁰

Regardless of subsequent interpretations by the courts, contemporary commentators concluded that the newly enacted FAA sought to achieve rather limited purposes: "The primary purpose of the statute is to make enforceable in the *federal courts* such agreements for arbitration, and for this purpose Congress rests solely upon its power to prescribe the jurisdiction and duties of the federal courts."⁵¹ Conceding that Congress, under the commerce clause, had power to regulate arbitration disputes in the state court, the conclusion was that Congress did not exercise that power under the FAA. Rather, Congress established a "procedure" in the federal courts to enforce arbitration agreements without "infringement upon the rights of each state to decide for itself what contracts shall or shall not exist under its laws."⁵² As the next few paragraphs reveal, this contemporary view on the limited scope of the FAA has been obliterated by the force of purposive judicial interpretation.

1. *Scope of "Transaction Involving Commerce."* The first step in the obliteration involves an expansive view of the transactions to which the FAA applies. The transactional scope of the FAA is delineated in two sections. FAA section 2 validates a "written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration" existing or future disputes. FAA section 1 expansively defines "maritime transactions" and "commerce"⁵³ but then

1915). The effect of the "ouster" doctrine was that a party who had agreed to arbitrate a future dispute could withdraw without an effective sanction anytime before the final award. See Sayre, *Development of Commercial Arbitration*, 37 YALE L.J. 595 (1928).

47. See S. Rep. No. 536, 68th Cong., 1st Sess. 2 (1924).

48. Federal Arbitration Act, 9 U.S.C. § 2 (1982), also validates an "agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal . . ."

49. Federal Arbitration Act, 9 U.S.C. § 4 (1982).

50. Federal Arbitration Act, 9 U.S.C. § 3 (1982).

51. Cohen & Dayton, *supra* note 45, at 278.

52. *Id.* at 276.

53. Maritime transactions are defined as "charter parties, bills of lading of water carriers, agreements relating to wharfage, supplies furnished vessels or repairs to vessels,

excludes from the FAA "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce."

In interpreting these sections, the lower federal courts, with some support from the Supreme Court, appear to have read the language "contract evidencing a transaction involving commerce" to mean *any* transaction that Congress could have regulated under its commerce powers, a reading that includes most commercial transactions that relate in any way to commerce.⁵⁴ In the Fifth Circuit, at least, the "commerce" requirement may be satisfied by diversity of citizenship alone.⁵⁵ At the same time, the courts have made it clear that arbitration under collective bargaining agreements subject to the Labor Management Relations Act is not governed by the FAA.⁵⁶

This expansive reading of FAA section 2, although not conclusive, arguably excludes only those contracts between citizens of the same state where the essentials of the exchange occur within that state. It includes, however, a wide range of commercial and consumer transactions which contain written agreements to arbitrate.

2. *Application of the FAA in State Courts.* Broad though its transactional scope may be, the FAA does not create federal jurisdiction.⁵⁷ To litigate in a federal district court, the parties must either have diversity of citizenship or assert claims arising under some other federal

collisions, or any other matters in foreign commerce which, if the subject of controversy, would be embraced within admiralty jurisdiction." Federal Arbitration Act, 9 U.S.C. § 1 (1982). Commerce means "commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation" *Id.*

54. In brief, the Supreme Court, in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), rejected the narrow view that "commerce" should be limited to contracts between merchants for the interstate shipment of goods. Rather, the FAA applied to a consulting agreement which was "inextricably tied to . . . interstate transfer and to the continuing operations of an interstate manufacturing and wholesaling business." *Id.* at 401. This expansive interpretation coupled with the "liberal" policy favoring arbitration announced, in *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983), persuaded the Seventh Circuit to announce, in dictum, that Congress "intended the FAA to apply to all contracts that it constitutionally could regulate." *Snyder v. Smith*, 736 F.2d 409, 418 (7th Cir.), *cert. denied*, 469 U.S. 1037 (1984).

55. See *Mesa Operating Ltd. Partnership v. Louisiana Intrastate Gas Corp.*, 797 F.2d 238, (5th Cir. 1986), where the court said: "Citizens of different states engaged in performance of contractual operations in one of those states are engaged in a contract involving commerce under the FAA. Such a contract necessitates interstate travel of both personnel and payments." *Id.* at 243. *Accord* *Del E. Webb Constr. v. Richardson Hosp. Auth.*, 823 F.2d 145 (5th Cir. 1987) (contacts need not be substantial so long as they "relate" to commerce).

56. See Ray, *supra* note 43.

57. See Hirshman, *The Second Arbitration Trilogy: The Federalization of Arbitration Law*, 71 VA. L. REV. 1305, 1341-46 (1985), where the authorities are discussed.

statute, such as the antitrust laws. Thus, the FAA creates "federal rights and remedies but no federal question jurisdiction."⁵⁸

This jurisdictional omission initially created confusion on whether the FAA applied to agreements to arbitrate rights created by state law which were litigated in either the federal or state courts. Despite initial doubts, the current answer to that question is yes.⁵⁹ Moreover, the FAA displaces state law in the state courts to the extent that state law provides less support for arbitration than does federal law. This is the teaching of *Southland Corporation v. Keating*,⁶⁰ an important decision whose implications have yet to be fully understood.⁶¹

(a) The *Southland* Case. *Southland* is the personification of our franchise hypothetical on the state level. A franchisee class sued a franchiser in a state court for damages and other relief caused by alleged fraudulent misrepresentations and performance under franchise contracts. Some of the fraud rights were created by the California Franchise Act which, in addition, appeared to void provisions in franchise agreements purporting to waive access to a judicial forum.⁶² The franchise agreements also contained a broad arbitration clause and the FAA applied because the contracts "evidenced" a transaction in commerce. The parties, however, were not of diverse citizenship.

The franchiser sought to compel arbitration of all claims. The superior court granted the motion except for claims arising under the Franchise Act: The agreement to arbitrate those claims was void. The court of

58. *Id.* at 1345.

59. The complete answer unfolded in three steps. First, if there was diversity of citizenship and the FAA did *not* apply, (*i.e.*, the transaction did not "evidence" commerce), state arbitration law applied in the federal court to the extent that it was "outcome determinative." Thus, if state legislation, in regulating the franchise contracts, created statutory rights in the franchisee for fraud by the franchiser and declared that disputes over that right must be litigated in court, the Federal District Court would be bound. This is the teaching of *Erie* and its progeny. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938); see *Bernhardt v. Polygraphic Co.*, 350 U.S. 198 (1956); *Hirshman*, *supra* note 57, at 1309-24.

Second, if there is diversity of citizenship and the FAA *did* apply because there was a transaction in "commerce," the FAA applied in its entirety to arbitration disputes in the federal courts. This means that an agreement to arbitrate which was enforceable under FAA § 2 would prevail over state legislation limiting the arbitrability of statutory rights, whether the issue were characterized as "substantive" or "procedural." *Southland Corp. v. Keating*, 465 U.S. 1, 15 (1984). The Court said that it was "clear beyond question that if this suit had been brought as a diversity action in a federal district court, the arbitration clause would have been enforceable" (footnote omitted). *Id.*

Third, *Southland* also held that if there was no diversity of citizenship and the FAA *did* apply, the substantive and, perhaps, the remedial provisions of the FAA apply to litigation in the state courts.

60. 465 U.S. 1 (1984).

61. See *Hirshman*, *supra* note 57, at 1353-78.

62. The statute, based upon language in the 1933 Securities Act, provided: "Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void." CAL. CORP. CODE ANN. § 31512 (West 1977).

appeals reversed and ordered arbitration of all claims.⁶³ The California Supreme Court reversed in part and held, among other things, that the California Franchising Act should be interpreted to void agreements to arbitrate fraud claims created by that Act and that the statute did not contravene the FAA.⁶⁴ In short, the California legislature had determined that the statutory rights were not appropriate for arbitration.

Upon direct appeal, the Supreme Court reversed.⁶⁵ The Court, speaking through Chief Justice Burger, held that: (1) the FAA governed the dispute over the effect of state law, whether litigated in the state courts or in a federal court under diversity jurisdiction; and (2) section 2 of the FAA, which "validated" agreements to arbitrate future disputes, created a substantive federal rule which preempted the California Franchise Act to the extent that it voided agreements to arbitrate statutory fraud claims created by the Act. This conclusion was rooted in both the presumed intention of Congress when enacting the FAA and the power of Congress to regulate commerce: "In creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements."⁶⁶

According to the Court, the FAA created a "body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act."⁶⁷ Bolstered by a "liberal federal policy favoring arbitration agreements," this body of substantive law was enforceable in both state and federal courts. Further, in section 2 of the FAA, Congress "withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." The only escape from this preemption, apart from the agreement of the parties, was if (1) the agreement to arbitrate was not part of a contract "evidencing" interstate commerce or (2) the agreement to arbitrate was revocable under the "savings" clause of FAA section 2, *i.e.*, "upon such grounds as exist at law or in equity for the revocation of any contract."⁶⁸

63. *Keating v. Superior Court*, 167 Cal. Rptr. 481 (1980).

64. *Keating v. Superior Court*, 31 Cal. 3d 584, 645 P.2d 1192, 183 Cal. Rptr. 360 (1982).

65. The Court held that it had jurisdiction to decide whether the FAA preempted state law but not to review whether arbitration could be compelled in a class action. *Southland Corp. v. Keating*, 465 U.S. at 6-9 (1984).

66. *Id.* at 16 (footnotes omitted).

67. The Court quoted from *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

68. Federal Arbitration Act, 9 U.S.C. § 2 (1982). See *Perry v. Thomas*, 107 S. Ct. 2520, 2526 (1987), where the *Southland* decision was affirmed and applied to preempt a provision of the California Labor Law which stated that wage collection actions may be maintained without regard to the existence of any private agreement to arbitrate.

ARBITRATION OF STATUTORY RIGHTS

Justice Stevens, concurring and dissenting, urged a more flexible approach to the preemption question. He argued that the state policy "providing special protection for franchisees" could be recognized without impairing a basic purpose of the FAA, which was to make agreements to arbitrate future disputes "as enforceable as other contracts, but not more so."⁶⁹ Justice Stevens would have used the "savings" clause in FAA section 2 to examine the substance of the transaction at issue, the nature of the relationship between the parties, and the purpose of the state regulatory scheme. Even so, he did not discuss whether, between the poles of freedom of contract and the defense of public policy, arbitration had the capacity to deal with the particular issues involved. Justice Stevens apparently assumed that they were and balanced the state public policy against the FAA's strong pro-arbitration policy.⁷⁰

Attractive as it may be, Justice Steven's functional approach was rejected by the Court. Rather, the majority displaced state legislative limitations upon the arbitration of state created rights where the agreement to arbitrate was governed by FAA section 2. As a result, state legislative doubts about the capacity of arbitration to deal with statutory rights, whether created in the regulation of franchising, insurance,⁷¹ securities sales or consumer sales, are irrelevant even though the state otherwise has comprehensive, modern arbitration legislation.

(b) Displacement Effect of *Southland*. One effect of *Southland* is clear.⁷² The federal contract right to arbitrate will displace state law, no matter how clearly stated, that requires judicial resolution rather than arbitration in a particular dispute. Thus, in *Perry v. Thomas*,⁷³ the Supreme Court enforced the federal right to arbitrate which was in "unmistakable conflict with California's [legislative] requirement that litigants be provided a judicial forum for resolving wage disputes."⁷⁴

69. *Southland Corp. v. Keating*, 465 U.S. at 19 (quoting *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404, n.12 (1967)).

70. Justice O'Connor, joined by Justice Rehnquist, dissented. O'Connor could find no basis for concluding that either the Constitution or the FAA should be interpreted to preempt state regulation of arbitration, especially where those issues arose in state courts. *Id.* at 21-36.

71. See Comment, *Insurance Arbitration and the Standard Form Contract After Southland*, 30 S.D.L. REV. 617 (1985).

72. According to Professor Hirshman, the majority in *Southland* closed off two possible continuing roles for state law under the FAA:

First, the preemptive effect of the FAA . . . is not confined to state law based on historic, across-the-board hostility to arbitration: it displaces all state law limiting arbitration regardless of the underlying policy. Second, defenses directed to the formation of the arbitration agreement are treated . . . in the same way as other grounds for revocation under section 2 [FAA]. Accordingly, state-law restrictions on contracting for arbitration are no more immune to the impact of the FAA than restrictions on enforcement of the arbitration agreement after it is made.

Hirshman, *supra* note 57, at 1350.

73. 107 S. Ct. 2520 (1987).

74. *Id.* at 2526. *Accord* Fogarty v. Piper, 781 F.2d 662 (8th Cir. 1986) (FAA displaces

In addition, displacement is probable when state legislation imposes limitations upon the right to arbitrate not found in the FAA.⁷⁵ Thus, state laws that require agreements to arbitrate to be in conspicuous type or to satisfy higher standards of consent are vulnerable to displacement.⁷⁶ Further, state judicial decisions which refuse to enforce federal contracts to arbitrate on grounds not applicable to "any contract" are highly suspect.⁷⁷ Thus, a decision invoking a higher or different standard of fraud or unconscionability in arbitration than applied in other contractual disputes would be displaced.⁷⁸ On the other hand, state law which differs from but does not impose a limitation on the right to arbitrate under the FAA should be enforced.⁷⁹ As one court put it, while "inconsistent state law is preempted, not all state law is preempted upon application of the Act. State law should be preempted only to

limitation on arbitration imposed by state securities regulation); *Commerce Park at DFW Freeport v. Mardian Constr. Co.*, 729 F.2d 334, 338 (5th Cir. 1984) (FAA displaces prohibition of arbitration contained in Texas Deceptive Trade Practices Acts).

75. "We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law." *Southland Corp. v. Keating*, 465 U.S. 1, 11 (1984).

76. For a recent application, see *Webb v. R. Rowland & Co., Inc.*, 800 F.2d 803, 806-07 (8th Cir. 1986), holding that the FAA preempted a Missouri statute requiring an arbitration agreement to be in "ten point capital letters." This was so even though the contract stipulated that Missouri law applied. *See also Securities Industry Ass'n v. Connolly*, 703 F. Supp. 146 (D. Mass. 1988); *Bunge Corp. v. Perryville Feed & Produce*, 685 S.W.2d 837 (Mo. 1985); *Garmo v. Dean Witter, Reynolds, Inc.*, 101 Wash. 2d 585, 681 P.2d 253 (1984).

77. *See Federal Arbitration Act*, 9 U.S.C. § 2 (1982), which provides that the written agreement to arbitrate "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

78. In *Perry v. Thomas*, 107 S. Ct. 2520 (1987), the Court, in dictum, stated:

A state law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with . . . [FAA § 2]. . . . A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law. Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot.

Id. at 2527, n.9. The dictum that the application of state law must not discriminate against arbitration has been followed in California. *See, e.g., Heily v. Superior Court*, 202 Cal. App. 3d 255, 248 Cal. Rptr. 673 (Cal. Ct. App. 1988). *See also Brown v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 664 F. Supp. 969, 973-74 (E.D. Pa. 1987) (upholding arbitration agreement contained in an "adhesion" contract under FAA § 2).

79. *See New England Energy Inc. v. Keystone Shipping Co.*, 855 F.2d 1, 4-7 (1st Cir. 1988) (state statute permitting consolidation of two arbitrations does not limit FAA, which contains no consolidation provisions). *Compare Liddington v. Energy Group, Inc.*, 192 C.A.3d 1520, 238 Cal. Rptr. 202 (Cal. Ct. App. 1987), where the court held that the FAA preempted a provision of the California Code of Civil Procedure which authorized a court to enjoin arbitration pending the completion of litigation. Since a similar provision was not found in federal law, the power to enjoin, which applied "solely to arbitration" in effect limited arbitration in a manner not found in the FAA. *Id.* at 206.

the extent necessary to protect the achievement of the aims" of the federal act in question.⁸⁰

In summary, the Supreme Court has not construed the FAA to preempt all state law on arbitration. As one court put it, "at best, the Supreme Court's decisions support a conclusion that all state laws seeking to *limit* the use of the arbitral process are superseded by federal law."⁸¹ Further, those cases "concerned only laws that would override the parties' choice to arbitrate rather than litigate in court, in direct conflict with the Act's primary purpose of ensuring the enforcement of privately negotiated arbitration agreements."⁸² This reading, among other things, persuaded the Supreme Court in *Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University*⁸³ to hold that if parties otherwise subject to the FAA agreed to arbitrate and explicitly choose the law of a particular state which imposed limitations upon arbitration not found in the FAA, that choice of law would be enforced.⁸⁴

Nevertheless, the post-*Southland* developments still impose substantial limitations upon the power to the states to forbid or regulate arbitration in disputes over statutory rights created by state law.

C. Arbitrability and Separability: The Effect of Prima Paint

1. *Arbitrability*. Disputes over whether the agreement to arbitrate is enforceable inevitably involve the concept of arbitrability.⁸⁵ If the dispute is arbitrable, the court is empowered to compel arbitration under FAA section 4 and to issue an order staying any pending litigation under

80. *Wasyi, Inc. v. First Boston Corp.*, 813 F.2d 1579, 1582 (9th Cir. 1987), holding that a California definition of agreements to arbitrate which included "valuations [and] appraisals" was not displaced by the FAA. Although the FAA did not define arbitration so expansively, the California definition "does not conflict in any way with the federal policy favoring arbitrations agreements, and in fact seems to promote such policy. . . ." *Id.*

81. *New England Energy Inc. v. Keystone Shipping Co.*, 855 F.2d 1, 4 (1st Cir. 1988).

82. *Id.*

83. 109 S. Ct. 1248 (1989).

84. The United States Supreme Court affirmed *Board of Trustees v. Volt Information Sciences*, 195 Cal. App. 3d 349, 240 Cal. Rptr. 558 (Cal. Ct. App. 1987), review denied by California Supreme Court. The California Court of Appeals enforced the agreement to choose California law and its procedures, even though it invoked law which was arguably inconsistent with the FAA, *i.e.*, permitted a court to enjoin an arbitration pending litigation. Otherwise, the "effect would be to force the parties to arbitrate where they agreed not to arbitrate . . ." and this would be "inimical to the policies underlying state and federal arbitration law . . ." and "violate basic principles of contract law." *Id.* at 355, 240 Cal. Rptr. at 561. The *Volt* decision seemingly overrules decisions holding that such agreements are not enforceable. *Northern Illinois Gas Co. v. Airco Indus. Gases*, 676 F.2d 270, 274-75 (7th Cir. 1982); *Huber, Hunt & Nichols v. Architectural Stone Co.*, 625 F.2d 22, 25 (5th Cir. 1980); *Collins Radio Co. v. Ex-Cell-O-Corp.*, 467 F.2d 995 (8th Cir. 1972). The *Volt* case is discussed *infra* at text accompanying notes 232-40.

85. See generally Note, *Arbitrability of Disputes Under the Federal Arbitration Act*, 71 IOWA L. REV. 1137 (1986).

FAA section 3. If the dispute is not arbitrable, the court will not enforce the alleged agreement to arbitrate and may enjoin any arbitration that has been commenced.⁸⁶ The arbitrability question is resolved after an expedited hearing before the court or, in some cases, a jury.⁸⁷

Traditionally, a dispute is arbitrable if the parties have agreed in writing to arbitrate an existing or future dispute⁸⁸ and the particular dispute is within the scope of that agreement.⁸⁹ Determining the scope of an agreement to arbitrate is, in essence, a problem of contract interpretation, and is aided by what the Supreme Court has called a "liberal" policy favoring arbitration.⁹⁰ Thus, doubts in interpretation are likely to be resolved in favor of arbitration.⁹¹

Arbitrability, however, is subject to the claim that the agreement to arbitrate was invalid because of defects in the agreement process, such as fraud, duress, mistake or unconscionability⁹² or was unenforceable because arbitration in the particular setting was against public policy.⁹³ If either claim is established, the agreement to arbitrate will not be enforced.

2. *Separability*. Who decides that a dispute is not arbitrable, the court or the arbitrator? In 1967, the Supreme Court in *Prima Paint v. Flood & Conklin*,⁹⁴ recognized the separability of the agreement to arbitrate from the underlying contract in which it was contained. The

86. The judicial power to enjoin arbitration is thought to be incidental to the power inherent in every court to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants. See *Tai Ping Ins. Co. v. M/V Warschau*, 731 F.2d 1141, 1143-44 (5th Cir. 1984). The decision to enjoin arbitration, however, is discretionary and turns on the probability that, on the merits, the dispute is not arbitrable. *City of Meridian v. Algernon Blair, Inc.*, 721 F.2d 525, 527 (5th Cir. 1983).

87. See Federal Arbitration Act, 9 U.S.C. § 4 (1982).

88. Federal Arbitration Act, 9 U.S.C. § 2 (1982), provides in part: "[a] written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

89. See Note, *The Consequences of a Broad Arbitration Clause Under the Federal Arbitration Act*, 52 B.U.L. REV. 571 (1972).

90. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

91. See, e.g., *Louis Dreyfus Corp. v. 27,946 Long Tons of Corn*, 830 F.2d 1321, 1328-29 (5th Cir. 1987).

92. This exception is found in the "savings" clause in Federal Arbitration Act, 9 U.S.C. § 2, which states that the written agreement to arbitrate "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract" (emphasis added).

93. Unless this exception can be squeezed under the "savings" clause, the FAA provides no specific support for a "public policy" exception to arbitration. 9 U.S.C. § 2 (1982).

94. 388 U.S. 395 (1967). For the historical antecedents, see Nussbaum, *The "Separability Doctrine" in American and Foreign Arbitration*, 17 N.Y.U. L. REV. 609 (1940). For a contemporary reaction, see Comment, *Federal Arbitration Act and Application of the "Separability Doctrine" in Federal Courts*, 1968 DUKE L.J. 588.

distinction, although both elusive and difficult to justify,⁹⁵ is important because it expands the scope of arbitration: Although the court decides attacks on the validity of the arbitration clause itself, the arbitrator, if the agreement so provides, decides all attacks on the validity of the underlying contract. Perforce, the arbitrator also decides all questions involving the interpretation and application of the underlying contract.

Applying *Prima Paint* to our franchise hypothetical, the relevance of the separability doctrine to the capacity problem is clear. Apart from claims that the dispute is not arbitrable, all other questions of the enforceability of or liability and remedy arising from or relating to the underlying franchise agreement are for the arbitrator. Under a broad agreement to arbitrate, the arbitrator, not the court, decides whether the franchise agreement was induced for fraud and whether the franchiser committed fraud in performance and, if so, what remedies should be imposed.

D. Summary

Several pieces in the gradual federalization of private arbitration are now in place. The first is a broad interpretation of the "commerce" requirement in FAA section 2, which greatly expands the scope of the FAA. The second is the displacement by the Supreme Court of state law which limits the federal contract to arbitrate created under FAA section 2. The third is the separation of the merits of the dispute from questions of arbitrability at the threshold to arbitration, with the arbitrator empowered to decide both the validity of the underlying contract and the merits of the dispute if the agreement to arbitrate so provides. When "separability" and "displacement" are combined in disputes over state created statutory rights, the effect is to foreclose state attempts to regulate arbitrability and to confer broad, unreviewable power on the arbitrator to decide the merits.⁹⁶

There are two pieces left to consider: (1) what limitations are imposed at the threshold upon the federal contract right to arbitrate statutory rights created by other federal legislation; and (2) to what extent can a federal court review a final arbitration award which decided statutory rights created by either state or federal law under the FAA or otherwise.

95. Some of the difficulties in application are revealed in *Matterhorn, Inc. v. NCR Corp.*, 763 F.2d 866 (7th Cir. 1985) (opinion by Judge Posner).

96. See, e.g., *Lawrence v. Comprehensive Business Services Co.*, 833 F.2d 1159 (5th Cir. 1987) (question of illegality of underlying contract for arbitrator, Texas statute voiding agreement to arbitrate displaced under FAA § 2); *Russolillo v. Thomson McKinnon Securities, Inc.*, 694 F. Supp. 1042, 1044-46 (D. Conn. 1988) (provisions of Connecticut legislation that invalidated agreements to arbitrate securities claims displaced by the FAA and claims of illegality and violations of public policy under that act "not specifically directed to the arbitration clause itself" are for the arbitrator).

III. CAPACITY AT THE THRESHOLD: RISE AND FALL OF THE PUBLIC POLICY DEFENSE

A. Overview

In cases involving federally created statutory rights, to what extent have capacity problems, either effectiveness or appropriateness, influenced decisions on arbitrability under the FAA? Put differently, to the extent that the dispute is otherwise arbitrable, when have concerns about the capacity of arbitration persuaded the Supreme Court to refuse to enforce the agreement to arbitrate statutory rights?

Whatever the law may have been before 1987, the current answer is found in *Shearson/American Express, Inc. v. McMahon*,⁹⁷ where the Court held that neither the Securities Act of 1934 nor RICO⁹⁸ expressed an intention by Congress to preclude the arbitration of the statutory rights created therein. After reviewing the history and policy of FAA section 2, the Court announced its basic approach to the problem:

The Arbitration Act, standing alone, . . . mandates enforcement of agreements to arbitrate statutory claims. Like any statutory directive, the Arbitration Act's mandate may be overridden by a contrary congressional command. The burden is on the party opposing arbitration, however, to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue . . . If Congress did intend to limit or prohibit waiver of a judicial forum for a particular claim, such an intent 'will be deducible from (the statute's) text or legislative history' . . . or from an inherent conflict between arbitration and the statute's underlying purposes.⁹⁹

In short, unless Congress has clearly expressed its concern about arbitral capacity in the legislation that created the statutory rights, the agreement to arbitrate must be enforced. A court is not permitted to speculate about either the effectiveness or appropriateness of arbitration at the threshold. Exactly how did the Court reach this conclusion?

B. *The Rise of the Public Policy Defense: Wilko v. Swan and Its Progeny*

1. *Wilko v. Swan*. In 1953, the Supreme Court, in *Wilko v. Swan*,¹⁰⁰ was asked to decide whether a dispute, clearly arbitrable under the FAA, should be resolved in court because of congressional intention expressed in another federal statute, the Securities Act of 1933. A

97. 482 U.S. 220 (1987), *reh'g denied*, 108 S. Ct. 31 (1987).

98. Pub. L. No. 91-452, 84 Stat. 922 (1970).

99. *Shearson American Express, Inc. v. McMahon*, 482 U.S. at 226-27.

100. 346 U.S. 427 (1953).

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private investor, asserting a special right of action expressly created by Congress in the 1933 Securities Act, sued the defendant, a broker, in a federal district court for fraud in misrepresenting the affairs of a corporation, which was making an initial offering of stock. The defendant sought a stay of litigation under FAA section 3, claiming that the parties had agreed to arbitrate the claim in a broad arbitration agreement contained in the margin contract. The issue was joined when the plaintiff contended that arbitration was foreclosed by the terms of the 1933 Act. Congress had, in the 1933 Act, (a) created a private action for fraud, (b) provided that the action could be brought in either a federal or state court, and (c) placed the burden on the broker to prove the absence of scienter.¹⁰¹ More importantly, section 14 of the Act provided that "any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void." Section 14, however, did not clearly state that "any provision waiving a judicial forum to enforce rights created by this Act is void." The question was whether the antiwaiver provision should be so construed.

The district court denied the request for a stay, and held that the statutory rights must be enforced in court.¹⁰² The Second Circuit reversed in a two to one decision.¹⁰³ The Supreme Court, in a six to two decision, reversed the court of appeals and reinstated the ruling of the district court.¹⁰⁴ The Court, speaking through Justice Reed, interpreted the "anti-waiver" provision of the 1933 Act to void the agreement to arbitrate: The arbitration clause was a "stipulation" and the statutory right to select a judicial forum was a "provision" that could not be waived. In so doing, the Court viewed its task as attempting to reconcile the not easily reconcilable policies underlying two federal statutes, the FAA and the 1933 Act.

The Court employed a functional analysis. The FAA provided private parties with the opportunity to secure, through agreement, the advantages of arbitration "if the parties are willing to accept less certainty of legally correct adjustment." The 1933 Act protected the "rights of investors" and forbade the "waiver of any of those rights." The conclusion: "Recognizing the advantages that prior agreements for arbitration may provide for the solution of commercial controversies, we decide that the intention of Congress concerning the sale of securities is better carried

101. 15 U.S.C. § 77(d) (1982).

102. *Wilko v. Swan*, 107 F. Supp. 75 (S.D.N.Y. 1952).

103. *Wilko v. Swan*, 201 F.2d 439 (2d Cir. 1953). See Note, *Enforceability of Arbitration Agreements in Fraud Actions Under the Securities Act*, 62 YALE L.J. 985 (1953).

104. *Wilko v. Swan*, 346 U.S. 427 (1953).

out by holding invalid such an agreement for arbitration of issues arising under the Act."¹⁰⁵

It is clear, however, that the result was predicated upon the Court's assessment of what Congress "must have intended"¹⁰⁶ and that this assessment, in turn, was influenced by considerations of both arbitral effectiveness and appropriateness. The Court emphasized that Congress intended to protect investors deemed to be at a disadvantage. The Court stated that a predispute waiver of a judicial forum "surrenders" that advantage "at a time when he is less able to judge the weight of the handicap the . . . Act places on his adversary."¹⁰⁷ Furthermore, the Court stated that the effectiveness of the protection was "lessened in arbitration compared to judicial proceedings." In support of this conclusion, the Court made three points: (1) disputes under the 1933 Act were unlike the usual disputes submitted to arbitration, *e.g.*, disputes over the quality of goods or the price to be paid, in that the arbitrator must make a subjective determination of good faith and apply law without judicial supervision; (2) an arbitration award can be made without stated reasons or a complete record of proceedings; and (3) under the FAA, a court has no power to vacate an award for a mere error in the interpretation of law, although there may be authority to vacate for a "manifest disregard of law." Even so, there was no practical basis to vacate unless the error, however stated, is made "clearly to appear."¹⁰⁸

In so holding, the majority rejected Justice Frankfurter's contention that there was no evidence that either (1) the plaintiff's rights could not be fully protected in the system of arbitration chosen by the parties or (2) an unconscionable choice was forced upon the plaintiff at the time of contracting.¹⁰⁹

2. *The American Safety Doctrine.* In the first major showdown, the public policy defense prevailed at the threshold. Although predicated upon the presumed intention of Congress, the Court in *Wilko* emphasized the problems of choice and procedural adequacy faced by the plaintiff in agreeing in advance to arbitration. The Court did not clearly conclude that even if the choice was informed and the procedures were adequate, the issue was still inappropriate for arbitration. In fact, the Court left open that possibility that if the parties agreed to arbitration after the fraud dispute arose, that agreement would be enforced.¹¹⁰ Surprisingly,

105. *Id.* at 438.

106. *Id.* at 437.

107. *Id.* at 435.

108. *Id.* at 435-36. In concurring, Justice Jackson concluded that the majority should not have decided that the FAA precludes judicial review of an award for "error in interpretation of a relevant statute." *Id.* at 439.

109. *Id.* at 439-40.

110. *Id.* at 435. The Court emphasized the danger in agreeing to waive a right to sue in court "prior to any violation of the Securities Act." *Id.* Thirty-three years later,

the Supreme Court's decision in *Wilko* was virtually ignored by the commentators and, for the next fifteen years, rested in cold storage.¹¹¹

In 1968, however, *Wilko*'s spirit was revitalized by the Second Circuit to achieve a similar result under the federal antitrust laws.¹¹² In *American Safety Equipment Co. v. J.P. Maguire & Co.*,¹¹³ American Safety, a licensee, sought a declaratory judgment against the licensor, Hickok, that the license agreement was void *ab initio* under the Sherman Act and that no royalties were owed for past performance under the license. The licensor assigned the royalty claim of some \$321,000 to Maguire, which initiated arbitration under a broad arbitration clause in the license agreement. The plaintiff then sought a declaratory judgment of invalidity against Maguire and a preliminary injunction against the arbitration. Maguire then moved under FAA section 3 to stay the declaratory judgment action until arbitration was completed. The district court granted the stay and, apparently, required the parties to proceed to arbitration on all issues, including the validity of the license agreement.¹¹⁴

After first holding that the order was appealable, the court came to the crucial question: Was the statutory right created by the antitrust laws "of a character inappropriate for enforcement by arbitration"?¹¹⁵ Invoking the spirit of *Wilko v. Swan*, the court then held that the antitrust claims were "inappropriate for arbitration."¹¹⁶ The court conceded that a statutory claim could be arbitrated even though a federal statute created the right and provided the remedy. The question was whether the "federal statutory protection of a large segment of the

the Court endorsed the conclusion that "*Wilko* does not apply to the submission to arbitration of existing disputes . . ." Shearson/American Express, Inc. v. McMahon, 482 U.S. at 233 (1987) (citing cases).

111. For a rare, contemporary commentary, see Note, *Arbitration Under the Securities Act of 1933*, 49 Nw. U.L. REV. 101 (1954). A comment, written in 1977, claimed that most investors were unaware of *Wilko* and that the securities industry made no effort to inform them in the standard-form arbitration clause. Comment, *Arbitration of Investor-Broker Disputes*, 65 CAL. L. REV. 120 (1977).

112. During 1968, the New York Court of Appeals also held that agreements to arbitrate private claims arising under state arbitration law were against public policy. *In re Aimcee Wholesale Corp. v. Tamar Prods., Inc.*, 21 N.Y.2d 621, 237 N.E.2d 223 (1968). The cases are analyzed in Comment, *Private Arbitration and Public Enforcement: A Conflict of Policies*, 10 B.C. INDUS. & COMM. L. REV. 406 (1969).

113. 391 F.2d 821 (2d Cir. 1968).

114. To simplify what the court called a "procedural morass," I have ignored the fact that Hickok, the assignor, was also a party to the litigation and filed various motions. *Id.* at 823.

115. *Id.* at 825. The court avoided the Supreme Court's recent decision in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), by holding that the court rather than the arbitrator should decide the validity of the license agreement when the source of the invalidity was another federal statute. Otherwise, the arbitrator, under the "separability" doctrine, would have had power to decide the merits of the public policy defense.

116. *Id.* at 828.

public, frequently in an inferior bargaining position," was more important than the federal policy validating agreements to arbitrate future disputes. The answer was yes and the reasons responded to three overlapping concerns about arbitral capacity.

The first involved the presumed intention of Congress. There was no statutory language or legislative history to guide the court. Nevertheless, the court concluded that a claim that the underlying contract was invalid under the federal antitrust laws, whether asserted in a declaratory judgment or an action for treble damages, was not merely a private matter. The plaintiff acts as a private attorney general enforcing a "national interest in a competitive economy." Because of the adverse competitive impact of antitrust violations and the claim that the license, at the time of contracting, was an "instrument of illegality," "we do not believe that Congress intended such claims to be resolved elsewhere than in the courts."¹¹⁷

In bolstering its conclusion, the court next noted that the arbitration clause was contained in a contract of "adhesion" and concluded that Congress did not intend that "contracts of adhesion between monopolists and their customers should determine the forum for trying antitrust violations." In so doing, the court contrasted a case where the arbitration clause was fully bargained, the issue was relatively simple, and the contract was "perfectly proper" when made. The court also noted that it was dealing with an agreement to arbitrate future disputes rather than "an agreement to arbitrate made after a controversy has already arisen."¹¹⁸

Finally, the court raised questions about the effectiveness of the arbitral process to deal with antitrust claims. The issues in antitrust litigation are "prone to be complicated, and the evidence extensive and diverse, far better suited to judicial than to arbitration procedures."¹¹⁹ Furthermore, antitrust laws regulate the business community: "Since commercial arbitrators are frequently men drawn for their business expertise, it hardly seems proper for them to determine these issues of great public interest."¹²⁰

For these reasons, the court concluded "only that the pervasive public interest in enforcement of the antitrust laws, and the nature of the claims that arise in such cases, combine to make the outcome clear."¹²¹ The district court, therefore, erred in submitting the validity issue to the arbitrator and the case was remanded to determine, among other

117. *Id.* at 827.

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.* at 827-28.

things, whether the royalty claim was sufficiently separate from the validity issue that it could and should be arbitrated.¹²²

3. *Summary.* In retrospect, *American Safety*, decided fifteen years after *Wilko*, was the "high water" mark of the public policy defense.¹²³ The principle was restated by Judge Posner in 1983: "Federal Antitrust issues . . . are not arbitrable . . ." in the sense that "an agreement to arbitrate them would be enforceable They are considered to be at once too difficult to be decided competently by arbitrators—who are not judges, and often not even lawyers—and too important to be decided otherwise than by competent tribunals."¹²⁴ In short, both the contract "right" to and the presumed efficiency advantages of arbitration are thought to be outweighed by other considerations in the relevant context.¹²⁵

C. 1968-1987: The Decline of the Public Policy Defense

1. *International Transactions: The Mitsubishi Motors Case.* The decline of a defense to arbitration based upon the public importance of the statutory rights and judicial doubts about the capacity of arbitration was first announced in 1974, when the Supreme Court limited the scope of *Wilko* to domestic as opposed to international commercial transactions.¹²⁶

In 1985, the Court reinforced the line between domestic and international transactions in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*.¹²⁷ In a long and complex opinion, the Court held that an American court should enforce an agreement to arbitrate antitrust claims in Japan "when that agreement arises from an international transaction,"

122. *Id.* at 827-28. Subsequent decisions, without questioning the public policy decision, have wrestled with such questions as whether some claims are separate or whether the antitrust issues "permeate" the dispute and, if there is no permeation, whether arbitration of the separate issues should occur before or after adjudication in court of validity questions. Recent decisions show a reluctance to find "permeation" and a preference for arbitrating first. See, e.g., *NPS Communications, Inc. v. Continental Group, Inc.*, 760 F.2d 463 (2d Cir. 1985); *University Life Ins. Co. of Am. v. Unimarc, Ltd.*, 699 F.2d 846 (7th Cir. 1983). See generally Lee, *Antitrust and Commercial Arbitration: An Economic Analysis*, 62 ST. JOHN'S L. REV. 1 (1987); Allison, *Arbitration Agreements and Antitrust Claims: The Need for Enhanced Accommodation of Conflicting Public Policies*, 64 N.C.L. REV. 219 (1986).

123. For contemporary reactions to the decision, see Symposium, *Arbitration and Antitrust*, 44 N.Y.U. L. REV. 1069 (1969). The Symposium features an introduction by Judge Wilfred Feinberg, the author of *American Safety*, and articles by Robert Pitofsky, Lee Loevinger, and Gerald Aksen.

124. *University Life Ins. Co. of Am. v. Unimarc Ltd.*, 699 F.2d 846, 850 (7th Cir. 1983).

125. It is assumed, however, that an agreement to arbitrate an antitrust claim made after the dispute arose would be enforceable. See *Hunt v. Mobil Oil Corp.*, 654 F. Supp. 1487, 1516 n.101 (S.D.N.Y. 1987) (citing cases).

126. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

127. 473 U.S. 614 (1985). See Comment, *Enforcing International Commercial Arbitration Agreements—Post-Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 36 AM. U.L. REV. 57, 72-77 (1986).

even though the effect of the alleged anticompetitive conduct would be felt in Puerto Rico.¹²⁸ The Court recognized that *American Safety* had held that the rights conferred by the antitrust laws were "of a character inappropriate for enforcement by arbitration," but held that this conclusion, to the extent still viable in a domestic context,¹²⁹ should not control in international transactions: "we conclude that concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes require that we enforce the parties agreement . . ."¹³⁰

On the surface, both *Wilko* and *American Safety* survived this excursion into international waters. But seeds of doubt were planted about future applications at home. More particularly, *Mitsubishi* rejected all of *American Safety's* concerns about the effectiveness of arbitration and the capacity of arbitrators to decide antitrust disputes except the core, which was the "fundamental importance to American democratic capitalism of the regime of the antitrust laws" and the "central role" played by the private cause of action in enforcing this regime.¹³¹

The Court stated that "potential complexity" alone was insufficient to avoid arbitration:

[A]daptability and access to expertise are hallmarks of arbitration. The anticipated subject matter of the dispute may be taken into account when the arbitrators are appointed, and arbitral rules typically provide for the participation of experts either employed by the parties or appointed by the tribunal. Moreover, it is often a judgment that streamlined proceedings and expeditious results will best serve their needs that causes parties to agree to arbitrate their disputes; It is typically a desire to keep the effort and expense required to resolve the dispute within manageable bounds that prompts them mutually to forgo access to judicial remedies. In sum, the factor of potential complexity alone does not persuade us that an arbitral tribunal could not properly handle an antitrust matter.¹³²

128. *Id.* at 624.

129. The Court, in whittling away at the justifications for *American Safety*, concluded that the "core of the . . . doctrine—the fundamental importance to American democratic capitalism of the regime of the antitrust laws . . ." did not apply with the same force in international trade. *Id.* at 634-35.

130. *Id.* at 629. The Court's faith in both "international comity" and the efficacy of international arbitration has been doubted by the commentators. See Comment, *supra* note 126, at 85-92. For a more probing, theoretical critique, see Morgan, *Contract Theory and the Sources of Rights: An Approach to the Arbitrability Question*, 60 S. CAL. L. REV. 1059 (1987). Assuming that arbitration is otherwise appropriate for the particular dispute, Professor Morgan argues for a "theoretical perspective which recognizes an inherent distinction between those rights which flow naturally from one person's interaction with another and those which are imposed by the state in furtherance of the collective interest." *Id.* at 1082. This distinction, rather than concerns over appropriateness, should lead to a more satisfactory test to determine when public policy should prevail over private autonomy.

131. *Id.* at 634-35.

132. *Id.* at 633-34.

2. *Intertwined Issues and the "Liberal" Federal Policy Favoring Arbitration.* Frequently, in commercial disputes, arbitrable issues are intertwined with issues that are not. This occurs where the parties agree to arbitrate some but not all of the issues arising from a transaction. It also occurs where, under a broad arbitration agreement, some of the issues are not arbitrable because of the public policy defense but the public policy issues do not permeate the entire dispute. The question is what comes first, arbitration or litigation? How the court resolves the issues posed by intertwining will have an impact upon the efficacy of the public policy defense.

The Supreme Court has approached this question armed with a "liberal" policy favoring arbitration, first articulated in the 1983 decision of *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*¹³³ This "liberal policy" was further refined and applied in *Dean Witter Reynolds Inc. v. Byrd*.¹³⁴ The Court, in *Byrd*, held that in a dispute

3. *Arbitrability of Statutory Rights.* It is clear, after *Southland*,¹⁴⁰ that "arbitrability" is a question of federal law to be decided by the court rather than the arbitrator. Furthermore, federal law, whether

133. 460 U.S. 1 (1983). In *Moses H. Cone*, both a state court and a federal district court had jurisdiction to decide the same question, the arbitrability of a dispute arising under a construction contract and governed by the FAA. After the dispute arose, Cone filed an action in a state court to declare that Mercury had no right to arbitrate. Mercury then filed a diversity action in a federal district court and moved to compel arbitration under FAA § 4. In order to grant the motion, the district court would have to decide that the dispute was arbitrable.

The federal district court granted Cone's motion to stay arbitration under the FAA pending the state court's decision on arbitrability. The Supreme Court, after a direct appeal, reversed and held that the federal district court should have decided the arbitrability question and, if the dispute were arbitrable, compelled arbitration under FAA § 4. This was so even though the state action on the same issue was filed first and still pending and that not all of the issues arising from the contract were arbitrable.

In confronting the complexities of the doctrine of abstention, see Note, *Federal Court Stays and Dismissals in Deference to Duplicate State Court Litigation: The Impact of Moses H. Cone Memorial Hospital v. Mercury Construction*, 46 OHIO ST. L.J. 435 (1985), the Court conceded that one objective in a decision to abstain in favor of the state action was to avoid piecemeal litigation. The Court concluded, however, that the costs of bifurcated and piecemeal litigation were required by the FAA when necessary to give effect to an arbitration agreement: "the Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Id.* at 24-25. Thus was enunciated what the Court called "a congressional declaration of a liberal federal policy favoring arbitration agreements . . ." *Id.* at 24.

134. 470 U.S. 213 (1985). See generally Note, *Dean Witter Reynolds, Inc. v. Byrd: The Unraveling of the Intertwining Doctrine*, 62 DEN. L. REV. 789 (1985); Note, *The Enforceability of Predispute Arbitration Agreements Under 10(b) and 10(b)(5) Claims*, 43 WASH. & LEE L. REV. 923 (1986); Note, *Federal and State Securities Claims: Litigation or Arbitration?*, 61 WASH. L. REV. 245 (1986); Note, *Enforcing Arbitration of Federal Securities Law Claims: The Effect of Dean Witter Reynolds Inc. v. Byrd*, 28 WM. & MARY L. REV. 335 (1986); Note, *Investor-Broker Arbitration Agreements: Dean Witter Reynolds, Inc. v. Byrd*, 20 U.S.F. L. REV. 101 (1985).

where arbitrable securities claims under state law were intertwined with nonarbitrable claims arising under the 1934 Securities Act,¹³⁵ the district court should first order the arbitration of the pendent state claims,¹³⁶ even though bifurcated proceedings resulted and the risk of collateral estoppel in the subsequent federal proceeding was created. The Court recognized the tension between two federal policies behind the FAA, the enforcement of contracts to arbitrate and the promotion of efficient and speedy dispute resolution—both could not be achieved on the facts in *Byrd*. Which should prevail?

The Court concluded that “passage of the Act was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered, and we must not overlook this principal objective when construing the statute, or allow the fortuitous impact of the Act on efficient dispute resolution to overshadow the underlying motivation.”¹³⁷ Thus, the Court must “rigorously enforce agreements to arbitrate, even if the result is ‘piecemeal’ litigation, at least absent a countervailing policy manifested in another federal statute”¹³⁸

In sum, the liberal federal policy favoring arbitration has at least two objectives: (1) to enforce contracts to arbitrate and (2) to promote arbitration as an efficient system of dispute resolution. These components are usually complementary. When in conflict, however, the enforcement policy should prevail. Thus, the rule is to arbitrate those issues which can be severed even though (1) the nonarbitrable issues are in litigation and (2) there will be clear costs to efficiency, unless the public policy defense is determined to permeate the entire dispute.¹³⁹

3. Arbitrability of Statutory Rights. It is clear, after *Southland*,¹⁴⁰

135. Since *Dean Witter* did not raise the question, the Court declined to decide whether the *Wilko* doctrine applied to the 1934 Act. The case proceeded on the assumption that it did. *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 215 n.1 (1985). Concurring, Justice White stressed that the issue was still open and that contrary holdings in the lower courts “must be viewed with some doubt.” *Id.* at 225.

136. *Byrd* sued in a federal district court and alleged violations of both the 1934 Securities Act and state law. The district court had both diversity and pendent jurisdiction. *Dean Witter* moved to sever the pendent state claims, to compel arbitration of those claims but to stay arbitration until the federal claims were resolved. The district court denied *Dean Witter*’s motion in its entirety and, on appeal, the Ninth Circuit affirmed. The Supreme Court reversed insofar as the district court denied the motion to compel arbitration. In effect, the Court ruled that the state claims were severable from the federal claims and that the state claims should, under the arbitration agreement, be arbitrated even though the federal claims were still pending. *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985).

137. *Id.* at 220 (footnote omitted).

138. *Id.* at 221.

139. Arbitration experts must master such terms as “separability,” (*Prima Paint*, 388 U.S. at 414, 421) “intertwining,” (*Byrd*, 470 U.S. at 216) and “permeation.” For an example of the latter, see *Applied Digital Tech., Inc. v. Continental Cas. Co.*, 576 F.2d 116 (7th Cir. 1978) (antitrust issues so permeate dispute that district court cannot decide contract issues without deciding antitrust defense).

140. *Southland Corp. v. Keating*, 465 U.S. 1 (1984). See *supra* text accompanying notes 60-71.

that "arbitrability" is a question of federal law to be decided by the court rather than the arbitrator. Furthermore, federal law, whether created by Congress or selected from state principles, will be infused by the "liberal" policy favoring arbitration and will be binding in both the state and federal courts. Finally, after the *Byrd*¹⁴¹ case, it is clear that the federal contract right to arbitration will prevail over the claim that arbitration in the particular case will be, for whatever reason, inefficient. Put differently, the federal contract right to arbitrate will be enforced even though the dispute is not otherwise suitable for arbitration unless Congress, explicitly or implicitly, has declared that the particular dispute is not arbitrable.

There is one further wrinkle on arbitrability. In determining the scope of the agreement to arbitrate, private claims created by protective federal legislation will be treated the same as claims arising under other sources of law.

In *Mitsubishi*,¹⁴² the Court rejected the argument, made by Soler and supported by Justice Stevens, that statutory claims should be presumed to be outside of the scope of an arbitration agreement unless the parties have explicitly included it. Instead, the Court adopted a two-step inquiry: first, the district court should determine under normal principles of interpretation "whether the parties' agreement to arbitrate reached the statutory issues"¹⁴³ and, if so, second, the district court should determine whether "legal constraints external to the parties' agreement" foreclose the arbitration of those claims.¹⁴⁴

The Court refused to "color the lens" through which the scope of the agreement to arbitrate was determined by reference to the public policy question. That question, whether Congress has declared that the statutory rights were not suitable for arbitration, must be answered in step two.

4. *The Last Nail: The McMahon Case*.¹⁴⁵ In *Shearson/American Express, Inc. v. McMahon*,¹⁴⁶ the Court granted certiorari from the Second Circuit to consider two public policy defenses to an agreement between an investor and a broker to arbitrate:

any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof . . . in accordance

141. *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985). See *supra* text accompanying notes 134-38.

142. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985). For a discussion of *Mitsubishi*, see *supra* text accompanying notes 127-32.

143. *Id.* at 628.

144. *Id.*

145. For a full discussion of the events in the securities industry up to *McMahon*, see Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 MINN. L. REV. 393 (1987).

146. 482 U.S. 220 (1987), *reh'g denied*, 108 S. Ct. 31 (1987).

with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc., as I may elect.¹⁴⁷

The first was whether the *Wilko* doctrine,¹⁴⁸ decided under the 1933 Securities Act, should be extended to the 1934 Act. The Second Circuit had answered this question in the affirmative.¹⁴⁹ The second was whether the private rights created by Racketeer Influenced and Corrupt Organization Act¹⁵⁰ could be arbitrated or must be resolved in court. Again, the Second Circuit had held that RICO rights must be enforced in court.

It was a bad day for the Second Circuit. In a five to four decision, the Court refused to extend *Wilko* to the 1934 Act. In a unanimous decision, the Court held that RICO claims, otherwise within the scope of the agreement to arbitrate, must be arbitrated under section 2 of the FAA. In short, the public policy defense was rejected in both cases. The conclusion was that the McMahons had failed to "demonstrate that Congress intended to make an exception to the Arbitration Act for claims arising under RICO and the Exchange Act, an intention discernible from the text, history, or purposes of the statute."¹⁵¹ In both issues, the Court relied heavily upon its reasoning in *Mitsubishi Motors*, even though that decision was predicated upon the fact that an international transaction was involved.¹⁵²

The Court's discussion of the 1934 Act was preoccupied with issues of statutory interpretation. The intention of Congress to void agreements to arbitrate statutory claims was not sufficiently clear.¹⁵³ This uncertainty was not resolved by resort to doubts about arbitral capacity. Rather, the Court concluded that *Wilko* was best understood as a decision hostile

147. *Id.* at 223.

148. *Wilko v. Swan*, 346 U.S. 427 (1953). For a discussion of *Wilko*, see *supra* text accompanying notes 100-10.

149. *McMahon v. Shearson/American Exp., Inc.*, 788 F.2d 94 (2d Cir. 1986), *cert. granted*, 476 U.S. 812 (1986), *reh'g denied* 108 S. Ct. 31 (1987). *Contra Phillips v. Merrill Lynch, Pierce, Fenner & Smith*, 795 F.2d 1393 (8th Cir. 1986).

150. 18 U.S.C. §§ 1961-1968 (1982 & Supp 1985).

151. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. at 226-27.

152. The Court reiterated its conclusion in *Mitsubishi Motors* that questions about arbitral effectiveness raised at the threshold were insufficient alone to avoid arbitration. *Id.* at 232.

153. With regard to the Securities Act of 1934, there was no specific language in the 1934 Act dealing with the arbitrability of private rights created by the statute. There was language, however, identical to that in the 1933 Act which might be construed to support an antiwaiver intention. But this language, according to the Court, did not support the conclusion that Congress intended to invalidate agreements to arbitrate 1934 Act claims: rather, it made "void" a waiver of compliance with the Act, not the waiver of a judicial forum to enforce rights created by the act.

Finally, the Court concluded that recent amendments to the securities act did not support an intention by Congress to incorporate the interpretation of *Wilko* of statutory language common to both acts without actually amending the 1934 statute. *Id.*

to or suspicious of arbitration rather than a decision that Congress, by the statutory language common to both the 1933 and 1934 Acts, intended to void arbitration agreements. The basis for the hostility has been eclipsed by subsequent decisions of the Court affirming the adequacy of arbitration in complex cases involving federal statutory rights. Even if the suspicion was well founded in 1953, oversight by the Securities Exchange Commission of the arbitral process in the securities industry has improved—the SEC now has sufficient statutory authority to ensure that the system of arbitration in investor disputes is adequate to vindicate statutory rights.¹⁵⁴

With regard to RICO, the Court found nothing in the language of the RICO statute¹⁵⁵ or the legislative history to support a conclusion that Congress intended to invalidate agreements to arbitrate private RICO claims. The question, then, was whether there was any irreconcilable conflict between the FAA and RICO's purposes? The answer was no. In the Court's opinion, neither the complexity of an issue nor its overlap with the law of crimes were sufficient to foreclose arbitration—a complex civil action can be arbitrated even though the underlying conduct may be prosecuted as a crime.¹⁵⁶

Justice Blackmun, with whom Justice Brennan and Justice Marshall joined, concurred in the decision on the RICO claim but dissented from the decision on the securities issue. Among other things, Justice Blackmun doubted whether the majority had given due regard to the congressional policy of investor protection, especially with regard to the capacity of arbitration to resolve the disputes:

154. The dissent, concluding that *Wilko* had been "effectively overruled," argued that the Court's interpretation of *Wilko* was too narrow; more was involved than a determination that arbitration was inadequate to protect statutory rights. Rather, *Wilko* concluded that Congress intended that those rights be vindicated in a judicial forum. Furthermore, the Court's ready acceptance of the protective vigil of the SEC over the arbitral process was suspicious. There was evidence of systemic bias that might not be adequately protected against in a judicial review of the award. This simply confirmed a probable intent of Congress to remove these claims from the arbitral process. *Id.* at 242—68.

155. Pub. L. No. 91-452, 84 Stat. 922 (1970).

156. Furthermore, the public interest in RICO litigation did not foreclose arbitration, because the primary purpose of creating private rights is to compensate for harm caused rather than to deter crime. The "private attorney general" thesis is even less persuasive in light of evidence that most private actions under RICO involve "run of the mill" crimes arising from transactions with legitimate enterprises where the agreement to arbitrate was made in advance. Finally, the Court was unconcerned about whether the deterrent effect of the private action could be accomplished in arbitration or whether the rights of the defendant in the quasi-criminal proceeding could be protected. The Court rejected the reasoning in cases like *Page v. Moseley, Hallgarten, Estabrook & Weeden*, 806 F.2d 291 (1st Cir. 1986), that a private action under RICO was "quasi-criminal in nature" and that the intent of Congress was to preclude arbitration and limit determinations of liability to the sole province of Article III courts. See Note, *Civil RICO is a Misnomer: The Need for Criminal Procedural Protections in Actions Under 18 U.S.C. § 1964*, 100 HARV. L. REV. 1288 (1987).

As even the most ardent supporter of arbitration would recognize, the arbitral process *at best* places the investor on an equal footing with the securities-industry personnel against whom the claims are brought. Furthermore, there remains the danger that, *at worst*, compelling an investor to arbitrate securities claims puts him in a forum controlled by the securities industry. This result directly contradicts the goal of both securities acts to free the investor from the control of the market professional.¹⁵⁷

D. Some Questions Answered

McMahon is the culmination of the judicial reaction to the antiarbitration seeds in *Wilko* and *American Safety*. As a result, the conclusions reached in both cases are under direct attack and may not survive.¹⁵⁸ More importantly, the emergence of the strong, unitary federal contract right to arbitrate provides a reliable basis to answer, at the threshold to arbitration, the Questions posed in conjunction with the franchise hypothetical in section I(D)(3).

First, the fact that an arbitration clause is contained in a contract of "adhesion" is no reason to deny enforcement. Although an agreement to arbitrate which is unconscionable under general principles of state law could be denied enforcement under the "savings" clause of FAA section 2,¹⁵⁹ there is no evidence of a judicial trend in that direction. Rather, just the opposite is true.¹⁶⁰ Moreover, state efforts to combat the risk of unfair surprise by requiring a higher standard of assent to arbitration clauses are displaced by *Southland*.

Second, the "broad" arbitration clause was interpreted in *Mitsubishi Motors*, without more, to include an agreement to arbitrate statutory rights.

Third, the Court presumes, at the threshold, that arbitration procedures are capable of providing a fair hearing in complex cases and that arbitrators have the competence to protect the statutory rights of the parties. So far, there is no indication what evidence *ex ante* arbitration, if any, would persuade the Court otherwise.

157. *Shearson/American Express v. McMahon*, 482 U.S. at 260.

158. *See, e.g., Rodriguez de Quijas v. Shearson/Lehman Bros., Inc.*, 845 F.2d 1296, 1299 (5th Cir. 1988), *cert. granted* 109 S. Ct. 389 (1988) (*McMahon* leads "directly to the obsolescence of *Wilko* and the arbitrability of Securities Act § 12(2) claims"); *Gemco Latinoamerica, Inc. v. Seiko Time Corp.*, 671 F. Supp. 972, 978-80 (S.D.N.Y. 1987), where the court concluded that *American Safety* had been eroded and that "none of the justifications for the . . . doctrine retain their vigor and that our court of appeals would now hold that domestic antitrust claims are subject to arbitration." *Wilko* was overruled in *Ofelia Rodriguez De Quijas v. Shearson/American Express, Inc.*, 57 U.S.L.W. 4539 (May 15, 1989).

159. *See Perry v. Thomas*, 107 S. Ct. 2520, 2527 n.9 (1987) (state law principle "that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with" the requirement of general application in the "savings" clause).

160. In California, at least. *See Heily v. Superior Court*, 202 Cal. App. 3d 255, 248 Cal. Rptr. 673 (Cal. Ct. App. 1988) (claim of former employee against broker subject to arbitration procedures of the New York Stock Exchange).

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Fourth, the Court presumes that an arbitration award can protect the interests of third persons and vindicate public interests in the dispute unless Congress has clearly stated that arbitration of those statutory rights shall not be permitted.

Finally, the Court has concluded that the states have no power to limit the federal contract right to arbitrate in transactions to which the FAA applies. Thus, the answers remain constant, except that a state legislature, no matter how clearly it speaks, cannot change them.

With the final pieces in place, consider this “worst case” scenario. Return to the franchise example. Suppose that a Franchiser or other regulated party, well aware of the Supreme Court decisions, decides to minimize the effect of state regulation of franchise agreements evidencing a transaction in commerce. Accordingly, it insists upon a broad arbitration clause whether the franchisee likes it or not. If that clause is otherwise enforceable under the “savings” clause, *Prima Paint* dictates that the arbitrator not the court is empowered to decide all of the claims involving statutory rights and *Southland* dictates that state efforts to limit that power are displaced by the FAA. In short, the agreement to arbitrate will be enforced. But what about judicial review? If the assumptions underlying the answers above do not pan out in fact, to what extent can a court under the FAA correct the defects on review of the final award?

IV. JUDICIAL REVIEW OF ARBITRAL CAPACITY

A. *Judicial Review of the Arbitration Award in General*

1. *Judicial Review Under the FAA.*

(a) Basic Policy. Under our franchise hypothetical, suppose that after the arbitration is concluded and a final award by the arbitrator is made, one party claims that the procedures were not effective or that the statutory rights were improperly applied by the arbitrator. More pointedly, the losing party claims that there was no fair hearing and that the arbitrator made errors of fact and law. To what extent can these claims be reviewed by a court in a motion to vacate a confirmed award or in subsequent litigation where the preclusive effect of the final award is urged? Is there a safety valve upon review under the FAA to avoid the excesses of the federal contract right to arbitrate at the threshold?

The conventional answer is no. An important goal of the parties and a central objective of arbitration is to obtain a final decision by the arbitrator of the dispute. Finality is part of the package that supposedly gives arbitration an advantage over litigation. It is a core ingredient in

the concept of arbitration.¹⁶¹ Even before the enactment of modern arbitration legislation, the courts were reluctant to overturn an arbitration award for errors of fact or law by the arbitrator.¹⁶² This general reluctance was codified in the FAA,¹⁶³ the Uniform Arbitration Act,¹⁶⁴ and other modern arbitration statutes.¹⁶⁵

Under the FAA, a statutory procedure to vacate or modify under FAA sections 10 and 11 is invoked through a timely motion after the arbitrator's final award. This motion may be made whether or not the other party has filed a motion to confirm and enforce the award.¹⁶⁶ Although the Supreme Court has not had an opportunity to interpret FAA section 10 since 1968,¹⁶⁷ the lower federal courts have been consistent protectors of finality. As the Second Circuit said in 1972, the court's function in review is "severely limited . . . being confined to determining whether or not one of the grounds specified . . . for vacation of an award exists."¹⁶⁸ This limitation was "to further the objective of arbitration, which is to enable parties to resolve disputes

161. For the rather sparse literature on review, see e.g., Jalet, *Judicial Review of Arbitration: The Judicial Attitude*, 45 CORNELL L.Q. 519 (1960); Note, *Judicial Deference to Arbitral Determinations: Continuing Problems of Power and Finality*, 23 UCLA L. REV. 936 (1976); Note, *Judicial Supervision of Commercial Arbitration*, 53 GEO. L.J. 1079, 1089-92 (1965); Note, *Judicial Review of Arbitration: The Role of Public Policy*, 58 NW. U.L. REV. 545 (1963); Note, *Judicial Review of Arbitration Awards on the Merits*, 63 HARV. L. REV. 681 (1950).

162. See, e.g., *Burchell v. Marsh*, 58 U.S. (17 How.) 344 (1854); *Wilkins v. Allen*, 169 N.Y. 494, 62 N.E. 575 (1902) (arbitrator's determination either as to the law or the facts is final and conclusive unless perverse misconstruction is plainly established); *W. Sturges*, *Commercial Arbitration and Award* § 366 (1930).

163. Federal Arbitration Act, 9 U.S.C. §§ 10 & 11 (1982).

164. Uniform Arbitration Act, 7 U.L.A. §§ 12 & 13 (1985 & Supp. 1987).

165. See, e.g., Section 7511 of the New York Arbitration Act, N.Y. CIV. PRAC. L. & R. § 7514 (McKinney 1980 & Supp. 1989) and Section 1286 of the California Arbitration Act, CAL. CIV. PROC. CODE § 1280-1298.8 (West 1982 & Supp. 1989).

166. Under the FAA, it is contemplated that the arbitrator's final award will be delivered to the parties. Either party then has three months in which to file a motion to "vacate, modify, or correct an award." Federal Arbitration Act, 9 U.S.C. § 12 (1982). If a timely motion is filed, the grounds and procedures for vacation or modification are set forth in FAA §§ 10 & 11.

Within one year after the award, however, either party may file a motion under FAA § 9 to confirm the final award. The court "must" grant an order to confirm unless the award has been vacated or corrected under FAA §§ 10 or 11. When an award is confirmed, the court will enter a judgment on the award and enforce it in the normal manner.

Note that the statutory procedures to vacate or correct a final award are, when timely invoked, available whether the award has been confirmed or not. If, however, the statutory procedures are not available, the finality of the award, whether confirmed or not, will usually be preserved by the doctrines of *res judicata* and collateral estoppel. See generally *Shell, Res Judicata and Collateral Estoppel Effects of Commercial Arbitration*, 35 UCLA L. REV. 623, 639-57 (1988).

167. See *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968), *reh'g denied*, 393 U.S. 1112 (1985), which wrestled with the meaning of "evident partiality" in FAA § 10(b).

168. *Office of Supply, Gov't of Republic of Korea v. New York Navigation Co., Inc.*, 469 F.2d 377, 379 (2d Cir. 1972) (citation omitted).

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promptly and inexpensively, without resort to litigation and often without any requirement that the arbitrators state the rationale behind their decision."¹⁶⁹ More recently, courts have affirmed that the "strong policy" favoring "voluntary commercial arbitration" requires that the judicial review of an arbitration award be "narrowly limited"¹⁷⁰ and that section 10 of the FAA provides the "exclusive grounds for challenging an arbitration award within its purview."¹⁷¹ Thus, under FAA section 10, the announced policy favoring finality suggests that a corrective or "safety valve" to the federal contract right to arbitrate is not readily available when issues of arbitral capacity are raised.¹⁷²

(b) Statutory Grounds Under the FAA. Under FAA section 10, there are two potential opportunities to obtain judicial review of claimed defects in capacity in the arbitrator's award. They are where the arbitrators "exceeded their powers"¹⁷³ or engaged in "misconduct" in the conduct of the hearing.¹⁷⁴ Other statutory grounds, such as fraud by the parties to the arbitration¹⁷⁵ or partiality or corruption in the

169. *Id.*

170. *Revere Copper & Brass v. Overseas Private Inv.*, 628 F.2d 81, 83 (D.C. Cir. 1980), *cert. denied*, 446 U.S. 983 (1981).

171. *LaFarge Concrets et Etudes, S.A. v. Kaiser Cement & Gypsum*, 791 F.2d 1334, 1338 (9th Cir. 1986). This firm stance under the FAA was reinforced in 1987 when the Supreme Court, in a labor dispute, upheld an arbitrator's award under a collective bargaining agreement despite claims that the arbitrator failed to conduct a fair evidentiary hearing and that the award was against public policy. *United Paperworkers Int'l. Union v. Misco, Inc.*, 108 S. Ct. 364 (1987). Although not bound by FAA § 10 in a labor dispute, the Court looked to the FAA for guidance. *Id.* at 372. See generally Edwards, *Judicial Review of Labor Arbitration Awards: The Clash Between the Public Policy Exception and the Duty to Bargain*, 64 CHI-KENT L. REV. 3 (1988); Ray, *Court Review of Labor Arbitration Awards Under the Federal Arbitration Act*, 32 VILL. L. REV. 57 (1987).

172. Until recently in Great Britain, the arbitrator could be required by the parties or the court to state issues of law arising before or as part of the award for review by the "High Court." Section 21(1) of the Arbitration Act of 1950. See Sayre, *The Development of Commercial Arbitration*, 37 YALE L.J. 595, 607-08 (1928) (origins of "case stated" procedure). In 1979, however, Parliament sharply limited the "case stated" procedure and abolished the jurisdiction of the High Court to vacate an award because of errors of law "on the face of the award." Arbitration Act, 1979, 27 & 28 Eliz. 2, c. 42, § 1(1). The 1979 Act requires the arbitrator to give a reasoned award and permits a right of appeal to the High Court "on any question of law arising out of an award made on an arbitration agreement." *Id.* at § 1(2). The High Court will grant leave to appeal only if all parties consent or if it "considers that, having regard to all the circumstances, the determination of the question of law concerned could substantially affect the rights of one or more of the parties to the arbitration agreement." *Id.* at § 1(4). Finally, the 1979 Act grants the parties to international arbitrations broad power to contract out of the limited right to appeal questions of law. *Id.* at § 1(5). See generally Samuel, *The 1979 Arbitration Act—Judicial Review of Arbitration Awards on the Merits in England*, 2 J. INT'L ARB., No. 4, 53 (1985).

173. Federal Arbitration Act, 9 U.S.C. § 10(d) (1982).

174. Federal Arbitration Act, 9 U.S.C. § 10(c) (1982).

175. A court will vacate where one party obtained the award by "corruption, fraud, or other undue means." Federal Arbitration Act, 9 U.S.C. § 10(a) (1982). Although this

arbitrators¹⁷⁶ are normally not relevant when arbitral capacity is challenged.

(i) Arbitrator Exceeded Authority. A court may vacate an award where (a) there was never an enforceable agreement to arbitrate or (b) the arbitrator otherwise exceeded his authority, as defined by the agreement and his office.¹⁷⁷

It is probably too late to claim for the first time that there was no agreement to arbitrate after the award has been made.¹⁷⁸ This objection is usually raised at the threshold. Nevertheless, the courts have considered, with uneven results, whether the arbitrator has exceeded his authority in interpreting the contract¹⁷⁹ or granting a particular remedy, such as specific performance.¹⁸⁰ Even though there may be no written opinion by the arbitrator, the courts are willing to review the result against the issues presented and the contract to see whether the decision

exception applies whether or not capacity problems are alleged, it obviously affords no assistance in capacity disputes where there is no fraud by one or both parties. The focal point here is upon improper means employed by one party to obtain the award rather than the partiality or misconduct of the arbitrator. The courts have been cautious in this arena. Thus, where fraud is alleged, the party seeking to vacate the award must prove it by clear and convincing evidence. In addition, the fraud must be material to an issue in the arbitration and must not have been discoverable by the exercise of due diligence prior to the arbitration. See *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378 (11th Cir. 1988), where the court vacated the award on the ground that the plaintiff's expert had completely falsified his credentials.

176. Federal Arbitration Act, 9 U.S.C. § 10(b) (1982), provides grounds for vacatur where there is "evident partiality or corruption in the arbitrators . . ." But what is "evident partiality . . . in the arbitrator . . . ?" Although the courts now agree that proof of actual partiality is not required, see *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968), *reh'g denied*, 393 U.S. 1112 (1968), there is some disagreement on what evidence short of that is needed to show "evident" partiality. The focus is upon what relationships and contacts the arbitrator should have disclosed at the time of selection rather than the impact of nondisclosure on the actual award. This inquiry is complicated by the fact that an experienced arbitrator in a particular trade or industry will undoubtedly have definite opinions and past and perhaps current relationships with one or both parties. A trade off is required that will rarely be helpful in disputes over capacity. See *Merit Ins. Co. v. Leatherby Ins. Co.*, 714 F.2d 673, 679 (7th Cir.), *cert. denied*, 464 U.S. 1009 (1983), where the court, speaking through Judge Posner, said: "The expert adjudicator is more likely than a judge or juror not only to be precommitted to a particular substantive position but to know or have heard of the parties (or if the parties are organizations, their key people)." According to Judge Posner: "If the circumstances are such that a man of average probity might reasonably be suspected of partiality, maybe the language of Section 10(b) can be stretched to require disqualification. But the circumstances must be powerfully suggestive of bias." *Id.* at 681. Compare *Morelite Constr. v. New York City Dist. Council Carpenters Benefit Funds*, 748 F.2d 79, 84 (2d Cir. 1984), where the test was whether a "reasonable person" would have to conclude that, if all the facts were known, the arbitrator was partial to one party.

177. Federal Arbitration Act, 9 U.S.C. § 10(d), which authorizes a vacatur where the arbitrators "exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made."

178. So holding is *Comprehensive Accounting Corp. v. Rudell*, 760 F.2d 138 (7th Cir. 1985).

179. See *Davis v. Chevy Chase Fin., Ltd.*, 667 F.2d 160 (D.C. Cir. 1981).

180. See, e.g., *Island Creek Coal Sales v. City of Gainesville*, 729 F.2d 1046 (6th Cir. 1984).

drew its essence from or was in manifest disregard of the agreement. In close cases, however, doubts will be resolved in favor of authority.¹⁸¹

Note that this route to vacatur does not depend upon a showing that the arbitration proceedings were ineffective or that the arbitrator made errors of law or fact. Rather, the result is articulated in terms of exceeding the authority granted by the agreement to arbitrate or, at a minimum, insuring that an issue clearly in the case was actually decided.¹⁸²

(ii) Misconduct by the Arbitrator. Another statutory ground that could be relevant to capacity is where the arbitrator was "guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced."¹⁸³

In this catchall provision, it is the arbitrator's misconduct or misbehavior in conducting the hearing rather than the effectiveness of the procedures when well conducted that is under scrutiny. The arbitrator's misconduct must "so prejudice the rights of a party that it denies the party a fundamentally fair hearing."¹⁸⁴ Without more, however, FAA section 10(c) seems to assume the parties are entitled to some hearing without delineating the nature or requirements of a fair hearing.¹⁸⁵ Thus, unless the parties have otherwise agreed,¹⁸⁶ the arbitrator's discretion in determining the nature and scope of the hearing is reviewed with a pro-arbitration bias under the vague fundamental fairness standard and a search for misconduct.¹⁸⁷ Put differently, it is doubtful that a party is

181. See *French v. Merrill Lynch, Pierce, Fenner & Smith*, 784 F.2d 902 (9th Cir. 1986), where the court was prepared to resolve all doubts in favor of authority "unless it may be said with positive assurance that the (agreement) is not susceptible of an interpretation that covers the award." *Id.* at 908.

182. See *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 638 (1985), where the court stated in dictum: "while the efficacy of the arbitral process requires that substantive review at the award-enforcement stage remain minimal, it would not require intrusive inquiry to ascertain that the tribunal took cognizance of the antitrust claims and actually decided them." *Id.* at 637, n.19.

183. Federal Arbitration Act, 9 U.S.C. § 10(c) (1982).

184. *Apex Fountain Sales v. Kleinfeld*, 818 F.2d 1089, 1094 (3d Cir. 1987).

185. See *Federal District Ins. Corp. v. Air Florida System, Inc.*, 822 F.2d 833, 842 (9th Cir. 1987), *cert. denied*, 108 S. Ct. 1289 (1988), where the court refused to hold that the petitioner was entitled to an oral hearing when a "paper" hearing was adequate for the resolution of the issue presented.

186. One frequent "otherwise" is to incorporate the AAA Arbitration Rules by reference into the contract. Rule 37 provides that the parties have a right to an oral hearing unless waived. American Arbitration Association Commercial Arbitration Rules Rule 37 (1986). Furthermore, Rule 31 provides that the parties "may offer such evidence as is relevant and material to the dispute and shall produce such additional evidence as the Arbitrator may deem necessary to an understanding and determination of the dispute." *Id.* at Rule 31.

187. In *United Paperworkers Int'l Union v. Misco, Inc.*, 108 S. Ct. 364 (1987), a dispute arising under a collective bargaining agreement, the Court considered whether the arbitrator's refusal to consider certain evidence amounted to "misconduct" under FAA

denied a fundamentally fair hearing simply because the arbitration procedures were, arguably, inadequate to deal with the complexity of the issue presented.¹⁸⁸

(c) Non-Statutory Grounds. At the conclusion of the arbitration hearing, there should be a record of the evidence, both written and oral, admitted for consideration by the arbitrator. The arbitrator, however, may or may not prepare a written opinion to justify the award. If not, the parties and any reviewing court will not know for sure what facts the arbitrator found to be established and persuasive, what law was applied or how the arbitrator justified the result. Consequently, it is difficult for a court to determine whether the arbitrator made any errors of fact or law. In short, the merits of the award are obscured.

To counteract this problem, a number of potential non-statutory grounds have evolved. They are, however, rarely invoked by a court as the basis for vacating an award. They include claims that the award was "completely irrational"¹⁸⁹ or "against public" policy or that the arbitrator was in "manifest disregard" of the law.

(i) Award Against Public Policy. Occasionally, a losing party will attack on the grounds that the award is against public policy. For example, the arbitrator might award punitive damages for breach of contract even though this remedy would not be available if the matter were litigated in court.¹⁹⁰ In these cases, the court could vacate the award on the ground that the arbitrator exceeded his authority¹⁹¹ or because the arbitrator acted in manifest disregard of applicable law. But if the arbitrator has authority and has not disregarded applicable

§ 10(c). The Court noted that if the dispute was arbitrable, procedural questions were left to the arbitrator. Even if there was error in refusing to consider evidence, it was not "misconduct" unless the error was in "bad faith or so gross as to amount to affirmative misconduct." The remedy for misconduct is to vacate the award, not to decide the merits. *Id.* at 372.

188. A final statutory ground is where the arbitrator made a mistake in description, a miscalculation of figures, or issued an award imperfect in form, but one which did not affect the merits. Federal Arbitration Act, 9 U.S.C. §§ 11, 10(d) (1982).

189. The claim that an award is "completely irrational" overlaps with the statutory ground that the arbitrator may not exceed his authority. Federal Arbitration Act, 9 U.S.C. § 10(d) (1982). Thus, where issues in the interpretation and application of the contract are involved, and the arbitrator's decision, when compared with the contract and the record, is excessive, a court might conclude either that the arbitrator exceeded his powers or that the decision was "completely irrational." See *Swift Industries, Inc. v. Botany Industries, Inc.*, 466 F.2d 1125, 1129-31 (3d Cir. 1972). Compare *Shearson Hayden Stone, Inc. v. Liang*, 653 F.2d 310, 312 (7th Cir. 1981). This approach, however, will not work if the court is persuaded that the arbitrator's decision drew its support from the essence of the contract.

190. See generally *Stipanowich, Punitive Damages in Arbitration: Garrity v. Lyle Stuart, Inc., Reconsidered*, 66 B.U.L. REV. 953 (1986).

191. See *John T. Brady & Co. v. Form-EZE Systems, Inc.*, 623 F.2d 261 (2d Cir.), *cert. denied*, 449 U.S. 1062 (1980) (suggestion that the public policy defense was another way of concluding that the arbitrator had exceeded his authority).

law and Congress had not clearly invalidated agreements to arbitrate the particular claim, the room for the public policy defense is sharply proscribed. As one court put it, the award must be "so misconceived that it 'compels the violation of law or conduct contrary to accepted public policy.'"¹⁹²

(ii) Award in Manifest Disregard of Law. In *Wilko v. Swan*,¹⁹³ the Supreme Court, in dicta, stated that "the interpretation of the law by arbitrators in contrast to manifest disregard are not subject, in federal courts, to judicial review for error in interpretation."¹⁹⁴ Conceding that this nonstatutory standard of review is "extremely limited," the "manifest disregard" of law standard for vacating an award has been adopted in the Second¹⁹⁵ and Ninth Circuits.¹⁹⁶

What is "manifest disregard" of the law? How is one to distinguish an interpretation of law that is simply "clearly erroneous"? Earlier, the Second Circuit expressed doubt about finding an answer: "One man's

192. *Revere Copper & Brass v. Overseas Private Inv.*, 628 F.2d 81, 83 (D.C. Cir. 1980), *cert. denied*, 446 U.S. 983 (1980) (quoting *Union Employers Division of Printing Industry, Inc. v. Columbia Typographical Union No. 101*, 353 F. Supp. 1348, 1349 (D.D.C. 1973) and refusing to vacate award). *Accord* *Dispulse Corp. of America v. Carba, Ltd.*, 626 F.2d 1108 (2d Cir. 1980), where the court stated that the award must compel the violation of law or be "contrary to well accepted and deep rooted public policy." *Id.* at 1110. The Supreme Court's decision in *United Paperworkers Inter. Union v. Misco, Inc.*, 108 S. Ct. 364, 373-75 (1987), reveals an even more constricted position. In a dispute under a collective bargaining agreement, the arbitrator reinstated an employee who had been discharged for the alleged possession and use of controlled substances on the employer's premises. The district court had vacated the award and the court of appeals affirmed on the ground that reinstatement would violate the public policy against the operation of dangerous machinery by persons under the influence of drugs or alcohol. The Supreme Court reversed and reinstated the award, primarily on the ground that the arbitrator had concluded, from the evidence before him, that there was no just cause for dismissal under the collective bargaining agreement. It was inappropriate for the lower courts to draw a contrary inference: "The parties did not bargain for the facts to be found by a court, but by an arbitrator chosen by them who had more opportunity to observe (the employee) and to be familiar with the plant and its problems." *Id.* at 374. Even so, the Court stated that for an award based upon the interpretation of a collective bargaining agreement to be against public policy, two things must be established: (1) the policy must be ascertained by reference to the laws and legal precedents and not from general considerations of supposed public policy; and (2) the violation of public policy must be clearly shown. Since neither condition was satisfied, it was improper to vacate an award made in accordance with an otherwise valid collective bargaining agreement.

193. 346 U.S. 427 (1953).

194. *Id.* at 436-37. Justice Frankfurter, in dissent, agreed that "(a)rbitrators may not disregard the law." *Id.* at 440.

195. *E.g.*, *Merrill Lynch, Pierce, Fenner & Smith v. Bobker*, 808 F.2d 930, 933-34 (2d Cir. 1986).

196. *See, e.g.*, *French v. Merrill Lynch, Pierce, Fenner & Smith*, 784 F.2d 902 (9th Cir. 1986). Other circuits, without expressly adopting the standard, have applied the "manifest disregarding" standard along with the statutory grounds in refusing to vacate an award. *See, e.g.*, *Stroh Container Co. v. Delphi Indus., Inc.*, 783 F.2d 743 (8th Cir.), *cert. denied*, 477 U.S. 1141 (1986); *MSP Collaborative v. Fidelity & Deposit Co.*, 596 F.2d 247 (7th Cir. 1979).

'interpretation' may be another's 'disregard.'¹⁹⁷ More recently the court has refined the test:

Manifest disregard requires something beyond and different from a mere error in the law or failure on the part of the arbitrators to understand or apply the law Manifest disregard of the law may be found . . . if the arbitrator understood and correctly stated the law but proceeded to ignore it.¹⁹⁸

Moreover:

The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover, the term "disregard" implies that the arbitrator appreciates the existence of a clearly governing legal principle but decides to ignore or pay no attention to it Judicial inquiry under the "manifest disregard" standard is therefore extremely limited. The governing law alleged to have been ignored by the arbitrators must be well defined, explicit, and clearly applicable. We are not at liberty to set aside an arbitration panel's award because of an arguable difference regarding the meaning or applicability of laws urged upon it.¹⁹⁹

Under this test, arbitrators have considerable latitude to err in the interpretation and application of statutory rights without being in "manifest disregard" of the law. These rights may be difficult to state and hard to apply to complex facts. Moreover, if the arbitrator does not prepare a written opinion, the applicable law cannot be delineated and analyzed. It will be difficult to determine whether the arbitrator identified applicable law and proceeded to reach a contrary position in spite of it. Thus, even though the court may inquire into the basis of an award, there will rarely be a non-statutory ground for vacating the award.

In sum, neither the statutory nor the non-statutory grounds for vacating an award offer a reliable corrective for capacity defects which emerge during the course of the arbitration.²⁰⁰

B. *Claim and Issue Preclusion as a Limitation on Review*

1. *Preclusion in Commercial Arbitration.* The finality objective in arbitration is complemented by the policies of efficient and effective

197. *I/S Stavborg v. National Metal Converters, Inc.*, 500 F.2d 424, 432 (2d Cir. 1974).

198. *Siegel v. Titan Indus. Corp.*, 779 F.2d 891, 892-93 (2d Cir. 1986) (citations omitted).

199. *Merrill Lynch, Pierce, Fenner & Smith v. Bobker*, 808 F.2d 930, 933-34 (2d Cir. 1986).

200. Compare Motomura, *Arbitration and Collateral Estoppel: Using Preclusion to Shape Procedural Choices*, 63 TUL. L. REV. 29, 37-45 (1988).

judicial administration which underlie the doctrines of res judicata and collateral estoppel. Res judicata, now called claim preclusion, bars a subsequent suit based upon the same claim involving the same parties or persons in privity with these parties and any claim or cause of action that could have been arbitrated.²⁰¹ Collateral estoppel, now called issue preclusion, bars the relitigation of an issue identical to one involved in the prior proceeding which was actually contested and necessary to the final award. In addition, the party precluded must have been a party to the proceeding and had a full and fair opportunity to present the relevant evidence.²⁰²

Both doctrines have been applied when one party seeks to relitigate in court claims and issues of fact previously decided by an arbitrator.²⁰³ The application, however, has been on a case by case basis which takes into account the differences between arbitration and judicial proceedings.²⁰⁴ Thus, some courts have been reluctant to give preclusive effect to decisions where the differences between the previous arbitration and adjudication in court were pronounced.²⁰⁵ Based upon the conclusion that arbitration is fundamentally different from litigation, Professor Shell has argued that, in commercial arbitration at least, the policies justifying the preclusion doctrines are not appropriate for arbitral proceedings unless the parties have intended to give the arbitrator's decision preclusive effect.²⁰⁶ Since arbitration is a consensual not a public institution, the intention of the parties rather than a case by case analysis to see if the particular arbitration was sufficiently like litigation is a preferable basis for determining preclusion.

2. *Limitations Upon Preclusion in Labor Arbitration.* In labor arbitration, a distinction between rights arising under a collective bargaining agreement and rights created by the Constitution or legislation has been made in the judicial review of labor arbitration awards. In this process, the FAA does not bind the courts, although its provisions are sometimes applied by analogy.²⁰⁷

201. Shell, *supra* note 11, at 639-40.

202. *Id.* at 647-48. See also Motomura, *supra* note 200.

203. A leading case is Goldstein v. Doft, 236 F. Supp. 730 (S.D.N.Y. 1964), *aff'd*, 353 F.2d 484 (2d Cir. 1965), *cert. denied*, 383 U.S. 960 (1966). See RESTATEMENT (SECOND) OF JUDGMENTS § 84 (1982); Mobilia, *Offensive Use of Collateral Estoppel Arising Out of Non-Judicial Proceedings*, 50 ALB. L. REV. 305 (1986).

204. See Shell, *supra* note 11, at 641-47 (claim preclusion) and 649-54 (issue preclusion). See also Motomura, *supra* note 200, at 33-37, 45-52.

205. This is especially true for where issue preclusion is involved. If the arbitrator has not prepared a written opinion and informal or inadequate procedures have impaired one party's opportunity to present issues, it will be difficult to determine what factual issues were actually decided, much less to decide whether they were decided after a "fair and full" opportunity to litigate. See Shell, *supra* note 11, at 649-54.

206. *Id.* at 658-73.

207. See Ray, *Court Review of Labor Arbitration Awards Under the Federal Arbitration Act*, 32 VILL. L. REV. 57 (1987).

When the award involves the interpretation and application of the collective bargaining agreement, the Supreme Court has been a firm supporter of finality. From the so-called "Steel Workers Trilogy"²⁰⁸ through the recent *Misco* decision,²⁰⁹ the Court has been clear that the courts "play only a limited role when asked to review the decision of an arbitrator" and "are not authorized to reconsider the merits of an award even though the parties may allege that the award rests on errors of fact or on misinterpretation of the contract."²¹⁰ As long as the award "draws its essence" from the collective bargaining agreement, it will be enforced.

A different analysis is employed where important constitutional or statutory rights are involved. If the award decides employee rights created by Congress, such as civil rights protected in 42 U.S.C. section 1983 or antidiscrimination rights created under Title VII of the Civil Rights Act of 1964,²¹¹ the Court has taken a different approach to review. In a series of decisions, starting with *Alexander v. Gardner-Denver Co.*,²¹² the Court has both questioned the capacity of arbitration to decide the statutory claims and rejected the argument that a reviewing court was automatically precluded from considering the issue if previously decided by the arbitrator.²¹³ Rather, the arbitrator's decision should be admitted in a de novo hearing to determine what deference, if any, the court should give to the award.

The Court rejected automatic preclusion in two steps. First, the *Alexander* court stressed the limitations of arbitration and arbitrators in deciding statutory rights in the labor context. Thus, arbitration, as an informal procedure, was not the equivalent of courts in either fact finding or the establishment of a complete record. Further, the arbitrator's role was limited to effectuating the "intent of the parties rather than the requirements of enacted legislation"²¹⁴ and the "specialized competence of arbitrators pertains primarily to the law of the shop, not the law of the land."²¹⁵ Finally, in labor arbitration, arbitrators are

208. In particular, *United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960).

209. *United Paperworkers Int'l Union v. Misco, Inc.*, 108 S. Ct. 364 (1987).

210. *Id.* at 370.

211. 42 U.S.C. § 2000e-2(a)(1) (1982).

212. 415 U.S. 36 (1974) (involving Title VII of the Civil Rights Act of 1964).

213. See *Barrentine v. Arkansas-Best Freight Systems*, 450 U.S. 728 (1981), *cert. denied*, 471 U.S. 1054 (1985), *after remand*, 750 F.2d 47 (8th Cir. 1984) (claims created by Fair Labor Standards Act, 29 U.S.C. §§ 201-219 (1982 & Supp. III 1985)); *McDonald v. City of West Branch*, 466 U.S. 284 (1984) (claims created by 42 U.S.C. § 1983 (1982)). The cases are well discussed in Motomura, *supra* note 200, at 46-50; Comment, *Arbitral Deference and the Right to Make and Enforce Contracts Under 42 U.S.C. § 1981*, 82 Nw. U.L. Rev. 109, 116-22 (1988).

214. 415 U.S. at 56-57.

215. *Id.* at 57.

ARBITRATION OF STATUTORY RIGHTS

required to follow the language of the collective bargaining agreement even though it conflicts with statutory law. This creates the risk that the "interests of the individual employee may be subordinated to the collective interests of all employees in the bargaining unit."²¹⁶ In the view of the Court, these capacity limitations in arbitration were inconsistent with automatic issue preclusion.

Second, the *Alexander* Court, in a footnote, set forth the factors relevant to a determination of how much deference the reviewing court should give to the award.

We adopt no standards as to the weight to be accorded an arbitral decision (in Title VII cases), since this must be determined in the court's discretion with regard to the facts and circumstances of each case. Relevant factors include the existence of provisions in the collective bargaining agreement that conform substantially with Title VII, the degree of procedural fairness in the arbitral forum, adequacy of the record with respect to the issue of discrimination, and the special competence of particular arbitrators. Where an arbitral determination gives full consideration to an employee's Title VII rights, a court may properly accord it great weight. This is especially true where the issue is solely one of fact, specially addressed by the parties and decided by the arbitrator on the basis of an adequate record. But courts should ever be mindful that Congress, in enacting Title VII, thought it necessary to provide a judicial forum for the ultimate resolution of discriminatory employment claims. It is the duty of courts to assure the full availability of this forum.²¹⁷

Although the Court has yet to apply these factors to a particular case, it seems clear that the approach has been endorsed for all cases where claimed statutory rights are decided against the individual employee in labor arbitration.²¹⁸ Yet in none of these cases did Congress clearly provide that only a court and not an arbitrator could decide the dispute. Put differently, although the Court, under the test announced in *McMahon*, would have enforced the agreement to arbitrate at the threshold, it was prepared to review the merits of the decision on statutory rights after the award was made.

3. *Issue Preclusion Under the FAA.* To date, the Court has not decided whether the approach of *Alexander v. Gardner-Denver Co.* to

216. *Id.* at 58 n.19.

217. *Id.* at 60 n.22. The footnote has been repeated with approval in both *Barrentine*, 450 U.S. at 743 n.22, and *McDonald*, 466 U.S. at 292 n.13.

218. *But see* Comment, *supra* note 213, at 109, where the author questions the application of *Gardner-Denver* to disputes arising under 42 U.S.C. § 1981. Compare *Johnson v. United Food and Commercial Workers Int'l Union Local No. 23*, 828 F.2d 961, 966 (3d Cir. 1987), where the court distinguished employee rights "grounded in specific statutory provisions designed to provide minimum substantive guarantees to individual workers" from obligations incurred through contract or estoppel rather than "statutory entitlements."

issue preclusion will be applied to the judicial review of awards deciding statutory rights which are subject to the FAA.²¹⁹ The issue would arise if, after an arbitrator decided a statutory claim against the protected party, a law suit to enforce the claim rather than a petition to vacate the award were filed. An obvious defense would be that the arbitrator's decision on the statutory claim was *res judicata*.²²⁰

On one level, there is an apparent fit. There is a similar distinction between rights created by the contract and rights created by legislation regulating those contracts and there are similar concerns about the capacity of arbitration adequately to adjudicate the statutory rights. Furthermore, since Congress created the statutory rights one might infer an intention to insure enforcement in a judicial forum. As the Court put it in the *McDonald* case, "rejection of a rule of preclusion . . . and our rejection of a rule of deferral . . . were based in large part on our conclusion that Congress intended the statutes at issue in those cases to be judicially enforceable and that arbitration could not provide an adequate substitute for judicial proceedings in adjudicating claims under those statutes."²²¹ One could predict, therefore, that the Court might adopt this approach if the procedures were in fact inadequate or the arbitrator made a mistake in the interpretation and application of the law.²²²

On another level, there are problems with taking this step. First, FAA sections 10 & 11 limit the scope of review by providing what some courts have called the exclusive grounds for review of commercial arbitration awards. Since the FAA does not apply in labor arbitration, the Supreme Court did not have to consider its potential limitations on judicial review in the *Alexander-Gardner* cases. A possible interpretation of the FAA, therefore, is that an arbitrator's award is final unless vacated under the statutory or nonstatutory grounds, as interpreted by the courts. Under this interpretation, the presumption of issue preclusion

219. The approach, as expressed in *McDonald v. City of West Branch*, 466 U.S. 284 (1984), was cited with apparent approval in *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985). *Byrd*, however, did not involve the judicial review of an award under the FAA. Rather, the question was whether arbitration or litigation should proceed first in a dispute that contained some issues that were arbitrable and some issues that were not. The Court held that arbitration must go first. In dealing with the argument that the arbitrator's award might have some preclusive effect in the subsequent litigation of nonarbitrable claims, the Court, among other things, suggested that the arbitration proceedings would not necessarily have a preclusive effect on subsequent federal court proceedings. Citing *McDonald*, the Court stated that the courts have power to determine the scope of preclusion after award and that "in framing preclusion rules in this context, courts take into account the federal interests warranting protection." *Id.* at 223.

220. So holding is *C.D. Anderson & Co. v. Lemos*, 832 F.2d 1097, 1099-1100 (9th Cir. 1987).

221. *McDonald v. City of West Branch*, 466 U.S. 284, 289 (1984).

222. See, e.g., Note, *The Preclusive Effect of Arbitral Determinations in Subsequent Federal Securities Litigation*, 55 *FORDHAM L. REV.* 655 (1987).

remains to complement the FAA's finality policy, should the issue arise in a context other than a motion to vacate.²²³

Second, there are differences between commercial and labor arbitration, primarily in degree of involvement of the individual in creating contract rights and the nature of the rights likely to be created by statute. A party to a commercial contract is not represented by a union. For better or for worse, he represents himself. Further, the rights created by regulatory legislation are farther removed from what might be called fundamental constitutional guarantees, whether or not implemented by federal legislation. The limitations of arbitration, therefore, pose risks of a lesser magnitude to individuals asserting statutory claims arising from the regulation of commercial or consumer transactions.²²⁴ These exceptions to issue preclusion, therefore, could easily be limited to collective bargaining agreements not otherwise governed by the FAA.

Third, under *McMahon*, unless Congress has clearly stated that arbitrable rights created by statute cannot be arbitrated, the court will order arbitration at the threshold. Arbitral capacity is presumed. If so, can a legislative intention to preserve access to a federal court to protect the federal interest after the award has been made be inferred? Put differently, if Congress did not clearly remove the dispute from arbitration at the threshold, how can an intention that the statutory rights be judicially enforceable be inferred after award? If this inference is not possible, a denial of preclusive effect could undermine the federal contract right to arbitrate.²²⁵

223. Courts give preclusive effect to unconfirmed but final arbitration awards. *Shell, supra* note 11, at 642 n.95.

224. *Compare* *Page v. Moseley, Hallgarten, Estabrook & Weeden*, 806 F.2d 291, 297 (1st Cir. 1986) where, in enforcing an agreement to arbitrate rights created by the 1934 Securities Act, the court distinguished the line of cases starting with *Gardner-Denver*:

(W)e note the express private right of action contained in the federal statutes at issue there, and that, at least with respect to (those cases) the federal statute at issue involved adjudication of the rights of an individual under the Constitution, an inquiry that, with all due respect to arbitration, has historically been the sole province of Article III adjudication.

Id. at 298.

The court concluded that the securities law implicates rights more akin to "the sort of commercial dispute that, absent a clear indication from Congress to the contrary, we would readily approve as arbitrable." *Id.*

225. *McDonald v. City of West Branch*, 466 U.S. at 289:

Our rejection of a rule of preclusion . . . and our rejection of a rule of deferral . . . were based in large part on our conclusion that Congress intended the statutes at issue in those cases to be judicially enforceable and that arbitration could not provide an adequate substitute for judicial proceedings in adjudicating claims under those statutes.

See *Steele v. L. F. Rothschild & Co., Inc.*, 701 F. Supp. 407 (S.D.N.Y. 1988), where the court refused to apply the reasoning of *Barrentine v. Arkansas-Best Freight Systems*, 471 U.S. 1054 (1985) to a threshold dispute between a nonunion employee and an employer under the Fair Labor Standards Act. Following *McMahon*, the court could find no evidence that Congress intended to preclude arbitration under the FLSA and concluded that

The policy question is clear: If an arbitrator's award against statutory rights has not been vacated or modified under FAA sections 10 & 11, should a court be able to inquire whether those rights were given full consideration under adequate procedures and decided according to law by a competent arbitrator? If the answer is yes, the rule of issue preclusion which normally complements FAA section 10 must give way to the *Gardner-Denver* standards for deference, which require a case by case analysis. Such a review ex post award would, arguably, undermine the federal contract right to arbitrate for the very same reasons that were rejected as grounds to deny enforcement by the Court at the threshold.²²⁶

In sum, modern arbitration law tends to shield the merits of the disputes over statutory rights from judicial review at both the threshold and the award stage. At the threshold, however, the Supreme Court assumes that the practice of arbitration is effective and the dispute is otherwise appropriate for arbitration if the parties have agreed to arbitrate. If a valid agreement exists, arbitration will be compelled unless Congress has clearly stated otherwise. If a final award is made, the award will be confirmed and enforced under the FAA unless egregious disruptions in process and procedure have occurred. The question "what disputes are appropriate for arbitration," if raised at all, is subsumed in the enthusiastic support for this ancient form of private adjudication and cannot easily be raised in court at either the threshold or the review stage.

Nevertheless, the Supreme Court has yet to consider the standard for review of an award deciding statutory rights created by Congress or by the states under the FAA. As the foregoing discussion reveals, there are opportunities for closer judicial scrutiny, but they run counter to the historical preference for finality manifested in the FAA and the cluster of policies in and around the doctrines of claim and issue preclusion.

that *McMahon* rejected the view "that arbitral tribunals are incompetent for resolution of the public law and policy considerations underlying the FLSA." *Id.* at 408. *But see* *Ferreri v. First Options of Chicago, Inc.*, 661 F. Supp. 1186 (E.D. Pa. 1987), where the court, without exploring the question of legislative intention, actually reviewed the record and concluded that the "arbitration in this case did provide a fair, complete and adequate substitute for a judicial trial." *Id.* at 1187.

226. Distinguishing between claim and issue preclusion, Professor Motomura has argued that arbitral findings should never be subject to issue preclusion in subsequent litigation unless the agreement clearly and expressly provides for it. In this, he agrees with Professor Shell that preclusion should depend upon the intention of the parties to the arbitration agreement rather than how closely the arbitration procedure resembles litigation. Further, a rule that predictably denies collateral estoppel effect will avoid unnecessary discouragement of arbitration and undesirable pressure on arbitration to become more like litigation. As a result, a court which has doubts about the wisdom of ordering arbitration can predict when the preclusion doctrines will or will not apply. If preclusion is foreclosed by the parties clear agreement, the court should have less reluctance to enforce the agreement to arbitrate. Motomura, *supra* note 200, at 80-81.

V. CONCLUSION: DIRECTIONS FOR REFORM

A. *The Problem Restated*

In this Article I have examined agreements to arbitrate statutory rights created either by Congress or the state legislatures. It is in this regulatory setting that capacity differences between arbitration and court adjudication are most likely to emerge. Because arbitration is different from litigation, limitations on procedural effectiveness and appropriateness can hamper the vindication of statutory rights. Two other factors combine to exacerbate these potential limitations: (1) there may be a power imbalance between the parties to the agreement, the stronger of which is the regulated party; and (2) the Supreme Court has created a unitary and preemptive federal contract right to arbitrate under the FAA. These circumstances cast a pall over the current enthusiasm for arbitration.²²⁷ Why?

First, the bargaining power imbalance suggested by the phrase "contract of adhesion" raises a continuing question about the quality of assent to arbitration. In this context, where the dominant party is the regulated party, any analysis that celebrates the apparent intention of the parties to arbitrate statutory rights is suspect. Furthermore, any solution that depends primarily upon the intention of the parties should be rejected. Unlike the securities industry,²²⁸ there is no federal or state agency charged with monitoring the quality of arbitration practices and procedures. Thus, the monitoring is left to private institutions, such as the AAA, and the uncertain pressure of industry trade associations.

Second, the development by the Supreme Court of a strong, preemptive federal contract right to arbitrate ignores the limitations of arbitration at the threshold. Unless Congress has clearly stated that federal statutory rights are not appropriate for arbitration, the courts are directed to order arbitration despite doubts about arbitral effectiveness. Furthermore, in cases to which the FAA applies, the Supreme Court has displaced state law which limits the federal contract right to arbitrate statutory rights created by the state. In short, there is little room for doubts about arbitral capacity to intrude at the threshold to arbitration.

Third, the doctrine of separability, under a "broad" arbitration clause, cedes to the arbitrator rather than the court the power to decide whether

227. See, e.g., Burger, *Using Arbitration to Achieve Justice*, 40 ARB. J. No. 4, 3 (1985).

228. On the oversight role by the SEC in the securities industry, see Fletcher, *Learning to Live with the Federal Arbitration Act—Securities Litigation in a Post-McMahon World*, 37 EMORY L. J. 99 (1988). This potential control has influenced courts at the threshold to enforce agreements to arbitrate fraud claims. See *Perace v. E.F. Hutton Group, Inc.*, 828 F.2d 826, 829 (D.C. Cir. 1987).

the underlying contract is enforceable under the "savings" clause in FAA section 2 and the merits of the statutory claim. Furthermore, the objective of finality which underlies the "classic" model of arbitration is reinforced in the limited statutory grounds to vacate an award under the FAA and in the doctrines of issue and claim preclusion. This effectively limits if not forecloses judicial review of the merits of the arbitrator's decision.

These developments create an incentive for organizations subject to federal or state regulation to use arbitration as a device to blunt or break social legislation, especially where the agreement to arbitrate is contained in a standard form prepared by the regulated party.²²⁹ Even if the arbitral practices and procedures are neutral, the limited capacity of arbitration in disputes over statutory rights coupled with the finality of the award could water down the protection provided for the other party, if not undermine the public policies underlying the regulatory legislation.

B. Some Directions for Reform

In essence, the arbitration of statutory rights creates a problem of consumer protection²³⁰ in the hazy areas between commercial and labor arbitration and federal and state law. But unlike commercial arbitration, where the limitations of arbitration may be strengths, statutory rights pose issues of public law which require a vindication that arbitration may be unable consistently to provide. In this area, therefore, the need to preserve the classic model of arbitration as a distinct alternative to litigation is less compelling. What are the most promising directions for reform?

1. *The Role of Private Agreement: The Decision in Volt Information Sciences.* Accepting this, solutions that depend primarily upon the agreement of the parties should be rejected, especially where the effect is to favor arbitration in derogation of statutory rights. Under this approach, the presumption, rejected by the Court in *Mitsubishi Motors*, that statutory rights are not arbitrable unless explicitly *included* in the agreement makes good sense and should have been adopted. Furthermore, the suggestion, made by Professor Motomura,²³¹ that a final award should have no collateral estoppel effects unless the parties have clearly agreed otherwise is suspect in disputes over statutory rights. Agreement man-

229. Compare the dissent of Judge Clark in *Wilko v. Swan*, 201 F.2d 439, 445 (2d Cir.), *rev'd*, 346 U.S. 427 (1953).

230. See Note, *Resolving the Conflict Between Arbitration Clauses and Claims Under Unfair and Deceptive Practices Acts*, 64 B.U.L. REV. 377 (1984) (consumer credit claims should not be arbitrated under state law).

231. Motomura, *supra* note 200, at 80-81.

ifested in an arbitration clause drafted by the regulated party, no matter how clear, should never be sufficient to insulate the final award from review for capacity defects.

On the other hand, if the parties clearly agree not to arbitrate or to exclude statutory rights from arbitration, that agreement will be enforced under the FAA.²³² But what about agreements to arbitrate under the law of a state which limits the arbitration of statutory rights? Should those agreements be enforced?

The general question was raised and partially answered by the Supreme Court in *Volt Information Sciences v. Board of Trustees of the Leland Stanford Junior University*.²³³ The parties to a construction contract agreed, (1) to arbitrate "all disputes . . . 'arising out of or relating to this contract or the breach thereof . . .'" and (2) that the "Contract shall be governed by the law of the place where the Project is located," namely California.²³⁴ The transaction, however, evidenced commerce and was subject to the FAA.²³⁵ A dispute arose over compensation for extra work. No state created statutory rights were involved. Rather, the Board of Trustees sought to stay arbitration under a procedural rule, section 1281.2(c) of the California Arbitration Act, pending litigation with other companies who were involved in the construction project but not parties to the arbitration agreement. There was, however, no provision authorizing a stay of arbitration in the FAA. Furthermore, the California procedural rule appeared to conflict with federal policy requiring arbitration first and litigation second.²³⁶ Nevertheless, the California Court of Appeals affirmed a stay of arbitration under section 1281.2(c) and the Supreme Court took appellate jurisdiction.²³⁷

The Court, in a six to two decision, affirmed. After first concluding that the choice of law agreement, properly interpreted, did incorporate the California procedural rule,²³⁸ the Court confronted the more difficult question: Was section 1281.2(c) preempted by the FAA even though

232. *Volt Information Sciences, Inc. v. Board of Trustees*, 109 S. Ct. 1248, 1255 (1989) (FAA does not require parties to arbitrate when they have not agreed to do so, nor does it prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement).

233. *Id.*

234. *Id.* at 1251 and n.1.

235. *Id.*

236. *See Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985).

237. 109 S. Ct. 1248, 1252, n.4. 238. The Court rejected the argument that the

238. The Court rejected the argument that the choice of law constituted a "waiver" of a federally guaranteed right. Rather, the parties had no federal rights beyond the scope of the agreement. Furthermore, there was no violation of the dictate that interpretation, a state law question, be done with "due regard" to the federal policy favoring arbitration. That policy was not offended when the agreement incorporated a "certain set of procedural rules" in a code that generally fostered the federal policy. The "federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate." *Id.* at 1253.

the parties had agreed to use it? The answer was no. The court noted that the FAA displaced state law only "to the extent that it actually conflicts with" the goals and policies of the FAA. An important policy is to require "courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms."²³⁹ This policy did not prevent the enforcement of agreements to arbitrate under different rules:

Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward.²⁴⁰

The *Volt* case, although a partial retreat from *Southland*, did not involve an agreement to arbitrate statutory rights in a regulatory setting. Rather, the limitation incorporated by reference was described as "procedural" and was an integral part of a modern state arbitration act that fostered arbitration. Furthermore, the procedural rule dealt with when rather than whether the agreed arbitration should proceed. Unlike *Southland*, the incorporated rule did not void any agreement to arbitrate specified statutory rights.

These distinctions leave open the ultimate question whether, in cases like *Southland*, a general choice of law agreement that incorporates substantive state prohibitions or limitations that are unique to arbitration will be enforced under the FAA? Will the Court simply enforce the general choice of law agreement or will it presume that unique and substantive limitations are not incorporated unless specifically identified in the agreement? This approach would be consistent with the conclusion in *Mitsubishi Motors* that the parties must clearly exclude statutory rights from a general agreement to arbitrate. Or would, as the dissenters in *Volt* argued,²⁴¹ such an agreement be so inconsistent with federal policy under the FAA that it must be denied enforcement?

The answers, obviously, must await that inevitable "next" case. But whatever the Court decides, the commitment to the preemptive effect of *Southland*, as tempered by the content and quality of the parties' agreement to arbitrate, appears to be firm.

2. *Arbitration of Federal Statutory Rights.* Assuming that the parties have agreed to arbitrate federally created statutory rights, three plausible directions for reform appear on the federal level.

First, Congress should be clearer about which federal statutory rights are appropriate for arbitration and which are not. Without the exclu-

239. *Id.* at 1255.

240. *Id.*

241. Justices Brennan and Marshall dissented. *Id.* at 1256.

sionary clarity required by *McMahon* (and without the benefit of the presumption rejected in *Mitsubishi Motors*), agreements interpreted to include federally created statutory rights will go to arbitration willy nilly.

Second, Congress should enact legislation modeled on the New Jersey Alternative Procedures for Dispute Resolution Act.²⁴² This legislation gives disputants power to contract into an extra-judicial dispute resolution system that varies from arbitration in several important ways: (1) the decision maker, a private party called an Umpire, is given "full jurisdiction to provide all relief and to determine all claims and disputes arising thereunder, including whether the particular dispute is covered by the agreement for alternative resolution, and whether there was fraud in the inducement of the entire contract";²⁴³ (2) each party is given a broad statutory right to discovery²⁴⁴ and, after a full hearing, the Umpire shall determine any question and render a final award which "shall state findings of all relevant material facts, and make all applicable determinations of law."²⁴⁵ Furthermore, the Umpire "shall make the award on all issues submitted for alternative resolution in accordance with applicable principles of substantive law";²⁴⁶ (3) finally, the courts are given broader power to review a decision by the Umpire. Although a "decision of the Umpire on the facts shall be final if there is substantial evidence to support that decision,"²⁴⁷ the award "shall be vacated" by the court if the rights of the applying party "were prejudiced by . . . the Umpire's committing prejudicial error by erroneously applying law to the issues and facts presented for alternative resolution."²⁴⁸ Similarly, the award may be vacated if the applying party was prejudiced by the Umpire's "(f)ailure to follow the procedures set forth in this act, unless the party applying to vacate the award continued with the proceeding with notice of the defect and without objection."²⁴⁹

242. N.J. STAT. ANN. §§ 2A:23A-1-23A-19 (West 1987). See Comment, *supra* note 31. A bill proposing a similar system was introduced in Congress in June 1987 for consideration by the House Judiciary Committee. H.R. 2721, 100th Cong., 1st Sess. (1987).

243. N.J. STAT. ANN. § 2A:23A-5(a) (West 1987). A claim that the alternative resolution clause was procured by fraud, however, is decided by the court. The Umpire also has broad power to consolidate separate agreements for dispute resolution or an agreement for dispute resolution and a judicial proceeding. *Id.* at § 2A:23A-3. See Stipanowich, *Arbitration and the Multiparty Dispute: The Search for Workable Solutions*, 72 IOWA L. REV. 473 (1987).

244. N.J. STAT. ANN. § 2A:23A-11(b) (West 1987).

245. *Id.* at § 2A:23A-12(a).

246. *Id.* at § 2A:23A-12(e).

247. *Id.* at § 2A:23A-13(b).

248. *Id.* at § 2A:23A-13(c)(5). The same test is applicable to a modification of an award. *Id.* at § 2A:23A-13(f).

249. *Id.* at § 2A:23A-13(c)(4).

The New Jersey statute responds directly to the concerns about the limitations of conventional arbitration in resolving disputes over statutory rights. As an alternative to both conventional arbitration and litigation in courts, it would provide an attractive possibility if the parties agreed to use it.

Third, federal courts should adopt and adapt the limitations upon issue and claim preclusion announced in *Alexander v. Gardner-Denver Co.* to disputes over statutory rights. In the absence of an alternative dispute resolution statute and in addition to the grounds to vacate in FAA section 10, a court should not be precluded from reviewing the merits of the arbitrator's final decision unless the other party can, at the very least, demonstrate that the arbitral procedures were substantially similar to those available in litigation and the arbitrator actually decided the questions of fact and law presented. This approach does not depend upon the intention of the parties. Rather, preclusion depends upon the adequacy and quality of the procedures involved in the arbitration.

The question remains whether any limitation on preclusion is consistent with the court's decision at the threshold that the dispute was arbitrable. Enforcement of an agreement to arbitrate federal statutory rights assumes that Congress did not clearly prohibit such an arbitration. The tentative answer is yes if a private agreement to settle the dispute over statutory rights would not be against public policy and there is a good chance that the parties might acquiesce in the arbitrator's final award without an appeal. To the extent that informed parties have power to settle a dispute over statutory rights and are satisfied with the arbitrator's decision, this variation on arbitration performs an important "weeding out" function. This function should be preserved, even though a more complete judicial review is available to either party.

3. *Arbitration of State Statutory Rights.* The interaction between the FAA and state imposed limitations upon the arbitration of state created statutory rights poses a more pressing problem. Under the *Southland* decision, suspect state limitations upon the federal contract right to arbitrate include the prohibition of arbitration in particular settings, the requirement of a greater informational disclosure before the agreement to arbitrate is enforceable and, presumably, the grant of a greater power to review final awards than is available under the FAA. *Volt Information Sciences* now provides a partial, affirmative answer to the question whether the parties can contract out of the FAA and into state law that imposes some limitations upon the federal contract right to arbitrate. Regulated organizations with opportunities to use the protective umbrella of the FAA that blunt the effect of statutory rights, however, will be unwilling to contract into those limitations. Limitations on *Southland* that are not dependent upon an agreement between the parties must, therefore, be devised.

ARBITRATION OF STATUTORY RIGHTS

The effect of *Southland* could be reduced without a direct attack on its underpinnings. A federal court could apply the presumption rejected in *Mitsubishi Motors* to the arbitration of state created statutory rights or enforce agreements between the parties to apply state law which contains limitations on the federal contract right to arbitrate. More importantly, the courts should review and, perhaps, restrict the broad interpretation of "contract evidencing a transaction in commerce" in FAA section 2. The contention that Congress, in enacting the FAA, intended to exploit its full power under the Commerce Clause is dubious.²⁵⁰ Moreover, the clear need in 1925 to protect transactions in commerce from the common law "ouster" doctrine has been obviated by the enactment in almost every state of modern arbitration legislation that enforces valid agreements to arbitrate future disputes. In short, there is no need for an across the board interpretation of FAA section 2 to equal the full power of Congress to regulate commerce.

A more direct approach would be for Congress or the Court to repudiate the *Southland* case, provided that two conditions were met: (1) the state has a general arbitration statute that is at least as good as the FAA; and (2) the state created limitations on the federal contract right to arbitrate state created statutory rights are otherwise within the state police powers and do not transgress the limitations imposed by the "dormant" or "unimplemented" commerce clause.²⁵¹ This approach, if adopted by Congress, would neutralize any incentive of the regulated party to misuse arbitration without disturbing existing and acceptable accommodations between state and federal power.

A final solution involves preclusion. At the very least, any court reviewing an arbitrator's final decision on state created statutory rights should have the same power as if a federal statutory right were involved. I have suggested that there should be no preclusive effect unless the other party establishes that the procedures available in arbitration were substantially similar to those available in court and that the arbitrator actually decided the relevant issues of fact and law. But where *Southland* applies and the state has limited the federal right to arbitrate, a better approach is to deny any preclusive effect to the merits of the final award. This result, although extreme, rests upon a sound policy conclusion: despite the FAA, a regulated organization should not be permitted to use arbitration as a device to neutralize or avoid otherwise

250. Although a definitive study of the legislative history has yet to be done, a careful review of the relevant documents reveals a high degree of uncertainty. See Note, *A Controversial Setting of a Settlement Controversy: The Supreme Court Declares the Federal Arbitration Act Preemptive of State Laws and Applicable in State Courts*, 36 ALA. L. REV. 273, 279-89 (1984).

251. See Redish & Nugent, *The Dormant Commerce Clause and the Constitutional Balance of Federalism*, 1987 DUKE L.J. 569.

valid state regulatory legislation. This means that a state or federal court should be empowered to determine on review whether the rights of the protected party and the public have been vindicated in the arbitral forum.

4. *A Final Word.* These suggested solutions apply in situations where neither the parties in their agreement nor Congress have clearly stated that the arbitration of statutory rights is not intended. They apply to the set of problems generated by the franchise hypothetical. They rest upon the assumption that conventional arbitration, over time, is not likely to provide adequate protection to the parties and the public for whose benefit the regulatory legislation was enacted.

The proposals, however, are not intended to constitute a "case against" arbitration. Rather, they call for an assessment of the strengths and weaknesses of conventional arbitration in regulatory settings and for particularized responses in the interest of improved arbitral capacity.²⁵² Until these problems are confronted in a realistic manner, the institution of arbitration must absorb the costs of the Supreme Court's zeal in interpreting the FAA.²⁵³ (1) the creation of a unitary federal contract right to arbitrate which ignores problems of arbitral capacity at the threshold; (2) the displacement of state law which limits or prohibits the arbitration of state created statutory rights; and (3) an invitation to regulated organizations who control the process of contracting to use arbitration as a device to blunt the force of regulatory legislation under the protective umbrella of the FAA. As this article goes to press, the Supreme Court's zeal was manifested once again: *Wilko v. Swan* has been overruled.²⁵⁴

252. Compare *Pearce v. E.F. Hutton Group, Inc.*, 828 F.2d 826, 829 (D.C. Cir. 1987), where the court, speaking through Judge Ginsburg, stated that the rationale for the liberal federal policy favoring arbitration is "at its strongest where the arbitration will be governed by procedures specifically tailored to the context from which the agreement to arbitrate arises, and will be conducted by arbitrators who are expert in the norms and practices of the relevant industry"

253. See Merrill, *The Common Law Powers of Federal Courts*, 52 U. CHI. L. REV. 1, 22-23 (1985), who suggests that the unwillingness or inability of Congress to legislate gives the "last word to the federal courts rather than to Congress." Further: "In practice . . . institutionalization of lawmaking by federal courts would represent a major shift in policymaking power away from Congress and toward the federal judiciary, in violation of the constitutional scheme."

254. *Ofelia Rodriguez De Quijas v. Shearson/American Express, Inc.*, 57 U.S.L.W. 4539 (May 15, 1989).